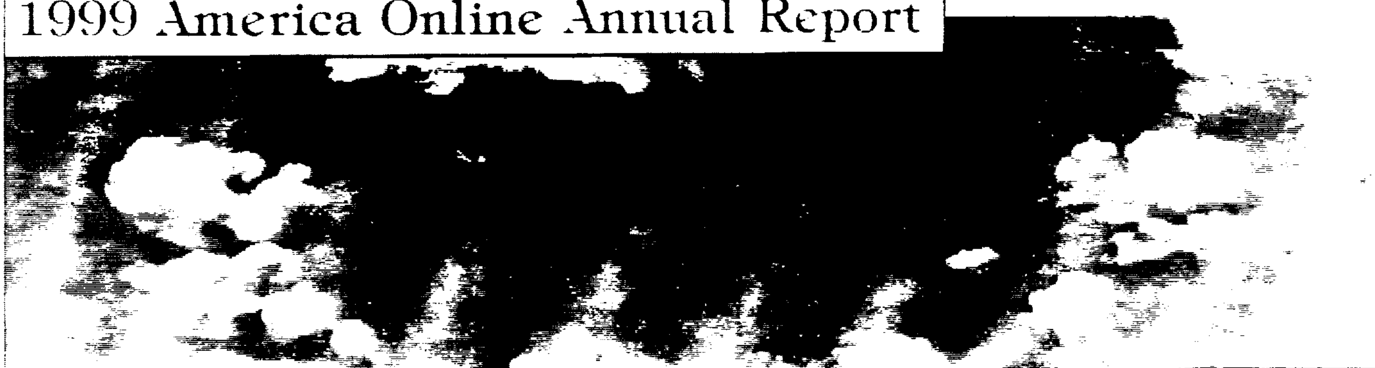
AMERICA Online

1999 America Online Annual Report



The Journey is Just Beginning.

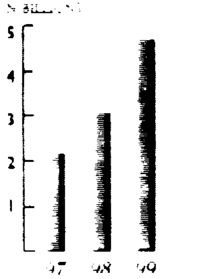
Our mission is to build a global medium
as central to people's lives
as the telephone or television...and even more valuable

Company Highlights

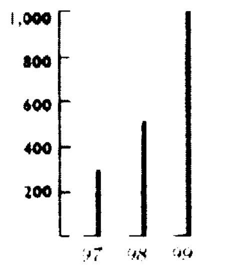
	Year Ended June 30		
	1999	1998	1997
Subscription Services Revenues	$ 3.321	$ 2.183	$ 1.478
Advertising, Commerce and Other Revenues	1.000	543	308
Enterprise Solutions Revenues	456	365	411
Total Revenues	$ 4.777	$ 3.091	$ 2,197
Operating Income	$ 578	$ 66	$ 6
Net Income	$ 396	$ 59	$ 10
EPS	$ 0.34	$ 0.06	$ 0.01
EBITDA	$ 968	$ 302	$ 111
AOL Members	17.619	12.535	8.636
Employees	12.100	8.500	7.400

Year Ended June 30

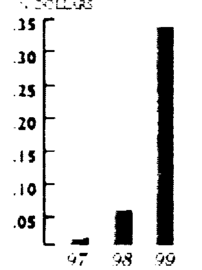
Total Revenues



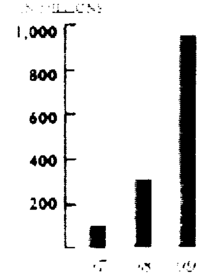
Advertising, Commerce and Other Revenues



EPS

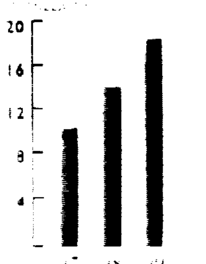


EBIDTA

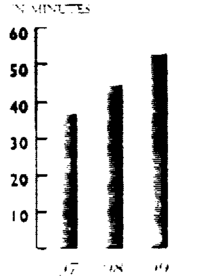


As of June 30

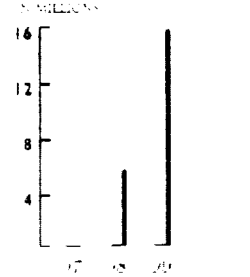
AOL Membership



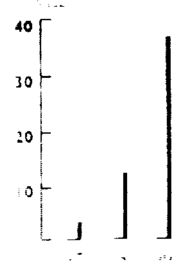
Member Usage per Day



Netcenter Registrants



ICQ Registrants

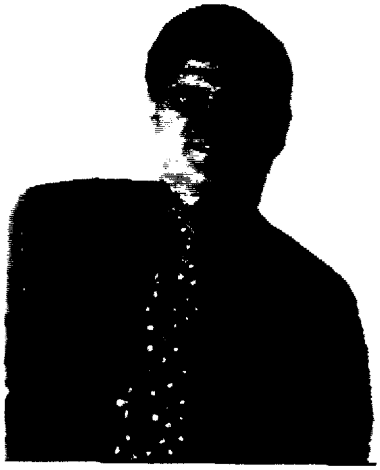


July 1998

AOL Membership	AOL & eBay	Election '98	Safe Surfin'	AOL Au...
exceeds 13 million	partner on a person-to-person online auction service on AOL	politics area launched by AOL	Web site and video launched for kids	launched ... and Berte... AG

AOL 000278

Shareholders:



Steve Case

Chairman and Chief Executive Officer

[illegible] interactive medium [illegible] ... even more [illegible] and the [illegible] world with the dawn of the new millennium [illegible] helping to lead the way – as we have for the [illegible].

The interactive experience is becoming increasingly embedded in consumers' everyday lives – everything from communicating, shopping, and keeping informed to investing, learning and just having fun. And nearly every company already has, or will, put its business online – seeking the benefits of the medium's efficiencies, convenience and reach.

America Online is leading this interactive revolution with our multiple brands. From the preeminent mass-market interactive brand – our flagship AOL service – to Netscape, CompuServe, ICQ, Digital City and MovieFone, we are able to target a wide range of opportunities. And to support all these brands, we have built a cost-efficient, shared infrastructure.

We believe the success of our Company grows from our direct and focused relationships with our customers – both members and partners. As our members' satisfaction and retention both reached all-time highs this past year, we are confident this focus on customers will drive our continued leadership of the Internet industry.

The Company's record financial and operational performance across our brands, and the steps we took to broaden and deepen our capabilities, have generated tremendous momentum for the coming year. In short, we are pleased to say that America Online has never been stronger. Our fiscal 1999 highlights included:

- ▶ Revenues reached $4.8 billion, a 55% increase over the previous fiscal year. Advertising, commerce and other revenues climbed 84% to $1 billion, with a backlog of committed revenues of $1.5 billion. The operating margin, before special charges, reached 16.4% in the fourth quarter.
- ▶ AOL's membership grew from 12.5 million to 17.6 million during fiscal 1999. Together with CompuServe, paying members totaled nearly 20 million, including more than 3 million combined AOL and CompuServe members outside the U.S. Registrants of our Web-based brands rounded out our multi-brand strategy with ICQ (38 million), Netscape Netcenter (17 million) and AOL Instant Messenger (25 million).
- ▶ America Online merged with Netscape Communications, and joined forces with Sun Microsystems to create the Sun-Netscape Alliance, to develop comprehensive e-commerce solutions for companies seeking to join the Net Economy.
- ▶ We introduced AOL in Australia, and prepared for AOL launches in Latin America and Hong Kong in FY 2000.

These achievements–and many more–strengthened our Company and kept up our momentum. More importantly, they helped us build on our core strengths:

• The most powerful collection of interactive brands • The largest base of paying customers in cyberspace • The strongest financial position in our history, sustained by multiple revenue streams • Alliances already in place to deliver services nationwide over broadband connectivity and other devices • Industry-leading technological expertise that makes interactivity simple and accessible for consumers • Strong international joint venture partners • Leadership focus on key public policy issues • A nimble and quick management team • A world-class organization of more than 12,000 experienced employees.

Taken together, these strengths position us to continue to deliver on our mission and to lead our [illegible] into the exciting future of interactive services.

[illegible] we are seeing the next wave of Internet growth on the horizon. Interactivity is fast moving [illegible] PCs connected to narrowband telephone lines. Consumers will have the ability to connect [illegible] as well as enjoy robust new high-speed online services, from interactive TV [illegible] broadband access.

Bob Pittman

President [illegible]

[illegible] 2[illegible] million registrants

connected to AOL

according to nearly half of Internet users in the AOL/Roper Starch Cyberstudy

is formed as a joint venture with the Cisneros Group

—The Flagship Service

Online

World's #1 Internet online service

Record membership growth in fiscal 1999 with more than 5 million new members

Members average more than 52 minutes a day

87% of members upgraded to AOL 4.0 after successful launch in September 1998

AOL 5.0 launches Fall 1999 with major innovations

Over 1,000 advertising, e-commerce and content partners

Digital City

digitalcity

- 60 markets nationwide

MovieFone

MovieFone

- Premier movie information and ticketing brand
- Available in more than 60 markets nationwide covering more than 19,000 movie screens
- Serves 1 out of every 5 moviegoers in America

[illegible]

First, online consumers are demanding new interactive tools and features to enhance their online experience and make it even more convenient and valuable to everyday life.

Central to fulfilling this demand are the [illegible] we made [illegible] the past year to broaden and enhance our offerings. Several [illegible] newly acquired companies are helping us build usage around key functions or categories, creating deeper and stickier [illegible] our members and other Internet consumers.

We have moved quickly to maximize Netscape's talent and technologies. For example, Netscape's expertise has enabled the development of an enhanced Web-based Quick Checkout "wallet" technology. And, with more than 17 million registrants, the addition of Netscape Netcenter to our portfolio of brands now gives the Company the #1 reach in the work and home audiences.

Extending our leadership in the fast-growing Internet music sector, we acquired Spinner Networks and Nullsoft's Winamp and SHOUTcast brands to provide the tools for our services and partners to develop customized music experiences. In addition, we bought MovieFone, the nation's largest online movie guide and ticketing service, and When.com, which allows us to offer the [illegible] popular application of online calendaring.

During the year we enhanced our core AOL service to provide even more [illegible] build on its value proposition. Following the success of AOL 4.0, which [illegible] member adoption rate of any previous software, we are introducing AOL 5.0 [illegible] next-generation client. Among its many exciting innovations is "You've Got Pictures," [illegible] our members to easily share photos online.

We also successfully introduced CompuServe 2000, and started growing that service's membership for the first time in years. We have positioned CompuServe as our value brand to enlarge the overall online audience by attracting price-sensitive consumers. We are continuing to grow ICQ and extend its communications functionality with services like free Web-based e-mail and ICQ-branded Internet telephony for its 38 million registrants. Also, Digital City offers local content in 60 markets nationwide, and has more than five million unique visitors monthly. We will continue to use our shared infrastructure to grow our brands and target strategic market segments.

Second, many Internet consumers are seeking to extend their interactive experience beyond the PC in an integrated, affordable and simple way.

We believe consumers are looking to AOL to pull all these interactive experiences together into a seamless and convenient package that requires, for example, just one e-mail address for any device or network. Over the past year, we extended our "AOL Anywhere" strategy with critical alliances and investments in interactive television, handheld connected devices and broadband [illegible]

Making real progress toward developing AOL TV for launch in the coming year, we [illegible] key partnering agreements with Philips Electronics for advanced set-top boxes [illegible] TV; Liberate Technologies for a comprehensive software platform; and Gemstar International [illegible] for electronic programming guides, which will be the cornerstone of the AOL TV [illegible] We also formed a strategic alliance with Hughes Electronics to offer AOL TV to Hughes DIRECTV subscribers.

Taking a first step to extend AOL-branded interconnectivity to handheld devices, [illegible] AOL e-mail available via personal organizers and we are exploring [illegible] featured version of AOL software for other portable devices.

Also, we are continuing to make progress in our commitment to embrace [illegible] high-speed access as they become ready for the mass market. Such a broad [illegible] suppliers using multiple technologies will provide us with the broadest [illegible] and help make broadband [illegible] consumers.

January 1999

[illegible]	$1 billion	Broadband	CompuServe
to provide exclusive broadcast news across multiple brands	exceeds 15 million	driven in 1998 holiday sales by AOL	alliances formed with Bell Atlantic, SBC, Ameritech and GTE to provide high-speed DSL access	[illegible]

AOL 000280

[illegible] Hughes [illegible] we will be able to offer [illegible] numbers [illegible]

Third, doing business and shopping online will become even more efficient and convenient as e-commerce reaches the next level of success.

Even as [illegible] Internet records for advertising and commerce revenues and for the total sales of goods and services, we continued to make it easier for businesses to go online and consumers to make Internet purchases.

During fiscal 1999, we signed 55 multi-year advertising and commerce agreements, each worth in excess of $1 million. In the Internet's largest ever advertising and marketing partnership, we reached a five-year agreement worth up to $500 million with First USA.

Designed to enhance the shopping experience across our brands, our Shop@AOL initiative is setting a new industry standard for consumer convenience. Shop@AOL provides seamless integration [illegible] commerce partners' sites and new Web-based tools to help them promote their products even more effectively on the service. In the coming year we will also introduce Shop@Netscape and Shop@CompuServe.

The Sun-Netscape Alliance has introduced iPlanet as its new product brand for its comprehensive, easy-to-deploy Internet infrastructure and e-commerce solutions. By fiscal year's end, more than 300 companies, including over half of the Fortune 100, turned to the Alliance to help put their businesses online.

Fourth, Internet use worldwide will explode with the increasing availability of connected devices.

Our multiple-brand strategy has strongly positioned us to take advantage of new opportunities around the world, as well as support our long-term global growth and leadership.

Over the past year, AOL International (including AOL and CompuServe) topped 3 million members outside the U.S., just 2-1/2 years after the first AOL International service was founded in Germany. Our strongest international brand, ICQ, continued its rapid overseas growth – with nearly two-thirds of its 38 million registrants based outside the U.S. In addition, Netscape Netcenter also boasts a significant international audience.

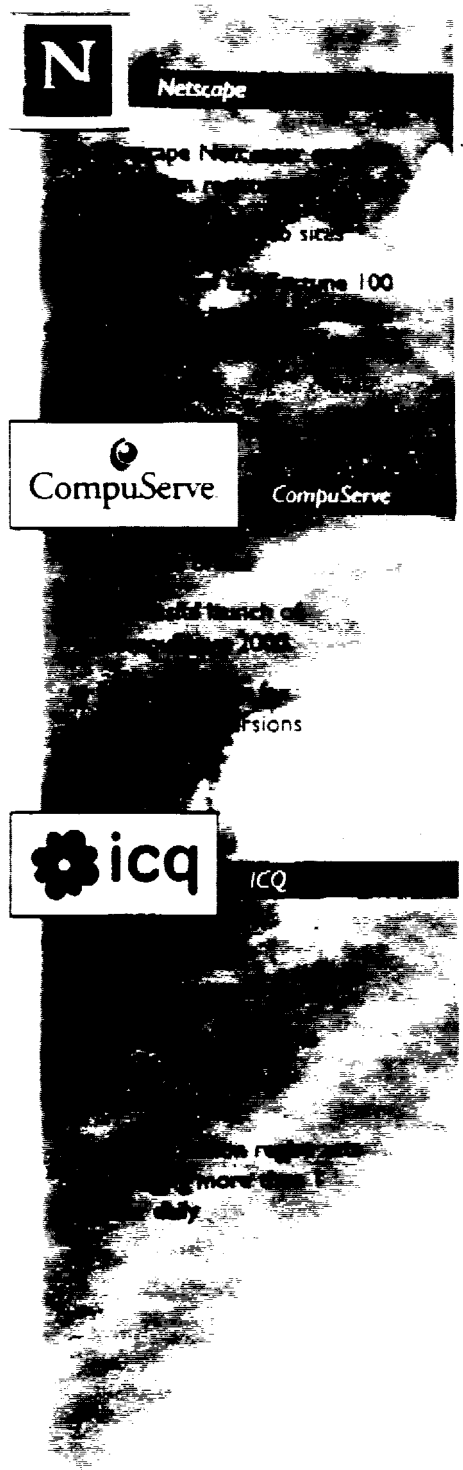
We are pleased with the momentum this past year in our AOL Japan service, and our new Australian service is making inroads into that market. With the Cisneros Group, AOL Latin America is gearing up to launch localized AOL services in Brazil, Mexico and Argentina. We also made a strategic investment in China.com to strengthen our role in the AOL Hong Kong service to be launched in the coming year.

In Europe, we extended our leadership as the largest pan-European Internet service with our AOL and CompuServe brands. In one new initiative, we are employing our multiple-brand strategy to launch Netscape Online, a new Internet service, for the emerging "subscription-free" value market in the U.K., where regulations allow ISPs to fund their basic operations with a share of [illegible] telephone bills.

Finally, as the medium becomes more central to people's lives, it will become increasingly critical that we build public trust and ensure that the medium serves the public interest.

[illegible] to take the lead on the full range of public policy and [illegible] issues [illegible] the growth of the Internet both in the United States and abroad.

[illegible] centered on creating a better environment for online [illegible] protecting privacy [illegible] [illegible] of the issues on which [illegible]

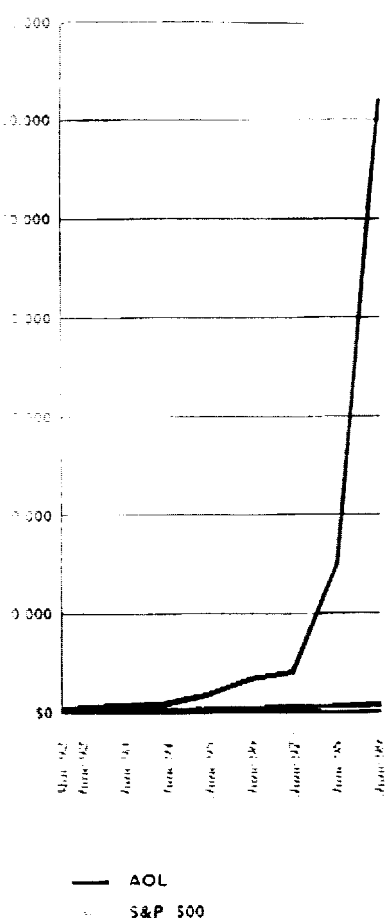


AOL and First USA	AOL Membership	ICQ	AOL acquires Netscape	When.com
forge the Internet's largest advertising partnership – 5 years, up to $500 million	exceeds 16 million	reaches 30 million registrants	and launches strategic alliance with Sun Microsystems	[illegible]

AOL 000281

...reholder Value

... vs. S&P 500



[illegible] AOL Foundation, now in its third year, [illegible] leadership role on all the [illegible] excited about its promise for the future.

To bring the full benefits of this medium to all people as quickly as possible, the Internet must continue to grow in an open environment where competition [illegible] and innovation [illegible]. We support a policy of open access for high-speed [illegible]

The Best Is Yet To Come

[illegible] walk the halls [illegible] through the workspaces at America Online, [illegible] dedicated, committed employees who come to work every day determined to make [illegible] We're proud [illegible] work with them and share their excitement about the future. [illegible] throughout our buildings around the world, our mission statement [illegible] future holds: "To build a global medium as central to people's lives as the [illegible] television ... and even more valuable."

As we prepare to usher in the new century, we are excited about the future of the Internet as a medium and our Company. To prepare for the coming opportunities of a more connected world, we are working hard to broaden and deepen our capabilities. We will remain [illegible] as the industry consolidates. Using our shared infrastructure, we will continue to [illegible] development of AOL and our other brands, our "AOL Anywhere" strategy and [illegible] international presence to make us even more central to the lives of our members and other Internet consumers.

All of the past year's successes underscore that America Online has never been in a better [illegible] operational and strategic position. We fully expect to accelerate this momentum [illegible] coming year. America Online will be better positioned than ever to lead the emergence of [illegible] connected society, create even more shareholder value and build a medium that [illegible]

Warm regards,

Steve Case
Chairman and Chief Executive Officer

Bob Pittman
President and Chief Operating Officer

www.aol.com/corp

Netscape Netcenter | **AOL membership** | **AOL** [illegible]

exceeds [illegible] million

AOL 000282

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 1999
Commission File Number - 001-12143

AMERICA ONLINE, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**54-1322110** (I.R.S. Employer Identification No.)
22000 AOL Way **Dulles, Virginia** (Address of principal executive offices)	**20166-9323** (zip code)

Registrant's telephone number, including area code: **(703) 265-1000**

Securities registered pursuant to section 12(b) of the Act:

(Title of Each Class)	(Name of Each Exchange on Which Registered)
Common Stock, par value $.01 per share	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes_X_ No_____

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

As of July 30, 1999, the aggregate market value of voting stock held by non-affiliates of the registrant, based upon the closing sales price for the registrant's common stock, as reported on the New York Stock Exchange, was approximately $104.4 billion (calculated by excluding shares owned beneficially by directors and officers).

Number of shares of registrant's common stock outstanding as of July 30, 1999.......1,108,080,083

DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K: Certain information required in Part III of this Form 10-K is incorporated from the registrant's Proxy Statement for its 1999 Annual Meeting of Stockholders.

PART I

Item 1. Business

General

Founded in 1985, America Online, Inc., based in Dulles, Virginia, is the world's leader in interactive services, Web brands, Internet technologies, and electronic commerce services.

America Online has two major lines of businesses organized into four product groups:

- the Interactive Online Services business, comprised of the Interactive Services Group, the Interactive Properties Group and the AOL International Group, and
- the Enterprise Solutions business, comprised of the Netscape Enterprise Group.

The product groups are described below.

The Interactive Services Group develops and operates branded interactive services, including:

- the AOL service, a worldwide Internet online service with more than 17 million members as of June 30, 1999
- the CompuServe service, a worldwide Internet online service with approximately 2 million members
- the Netscape Netcenter, an Internet portal with more than 17 million registered users
- the AOL.COM Internet portal
- the Netscape Communicator client software, including the Netscape Navigator browser

The Interactive Properties Group is built around branded properties that operate across multiple services and platforms, such as:

- Digital City, Inc., the No. 1 branded local content network and community guide on the AOL service and the Internet
- ICQ, the world's leading communications portal that provides instant communications and chat technology
- MovieFone, Inc., the nation's No. 1 movie guide and ticketing service provided through an interactive telephone service and on the AOL service and the Internet
- Internet music brands Spinner.com, Winamp and SHOUTcast

The AOL International Group oversees the AOL and CompuServe services and operations outside the United States, as well as the Netscape Online service, which will be launched soon in the United Kingdom.

The Netscape Enterprise Group focuses on providing businesses a range of software products, technical support, consulting and training services. These products and services enable businesses and users to share information, manage networks and facilitate electronic commerce.

In November 1998, America Online entered into a strategic alliance with Sun Microsystems, Inc. ("Sun"), a leader in network computing products and services, to accelerate the growth of electronic commerce. The strategic alliance provides that, over a three-year period, the Company will develop and market, together with Sun, client software and network application and server software for electronic commerce, extended communities and connectivity, including software based in part on the Netscape Enterprise Group code base, on Sun code and technology and on certain America Online services features, to business enterprises.

For a discussion of financial information about the Company's two lines of business, refer to Note 9 of the Notes to Consolidated Financial Statements.

During the fiscal year, the Company entered into a number of strategic mergers. In March 1999, the Company completed its merger with Netscape Communications Corporation and in May 1999, the Company completed its merger with MovieFone, Inc. The Company also completed mergers with Nullsoft, Inc. and Spinner Networks Incorporated, companies that provide music over the Internet, When Inc., a company that provides a personalized event directory and calendar services, AtWeb, Inc., and PersonaLogic, Inc.

America Online was incorporated in Delaware on May 24, 1985. The principal executive offices are located at 22000 AOL Way, Dulles, Virginia 20166-9323. The Company's telephone number at that address is (703) 265-1000. Inquiries may also be sent to America Online's Internet address: AOL IR@aol.com, or to the America Online address, AOL IR.

Products and Services

The Company's Interactive Online Services business is divided into three major product groups: the Interactive Services Group, the Interactive Properties Group and the AOL International Group. This line of business includes the Company's online and Internet services, Web properties and client software. The Company has developed a multiple-brand strategy of products and services that appeal to complementary and diverse groups of members or users of the Internet. The Company has also developed a multiple-revenue stream strategy designed to broaden the sources of revenues from its properties and services beyond subscription revenues to include revenues from sources such as advertising, commerce, licensing fees and transaction fees. The Company has augmented its online services with branded properties that add features or content across multiple services or platforms. Following these strategies has enabled the Company to operate the business and improve its services and products in a cost-effective manner by utilizing a shared infrastructure performing core functions.

Interactive Services Group

The Interactive Services Group operates the Company's interactive products: the AOL and CompuServe services and their related brand and product extensions such as AOL.COM and AOL Instant Messenger ("AIM"); Netscape Netcenter; and the Netscape Communicator client software, including the Netscape Navigator browser.

The AOL Service

The Company's AOL service, with 17.6 million members at June 30, 1999, provides subscribers with a global, interactive community offering a wide variety of content, features and tools. The AOL service also includes simple access to the Internet with search functionality through AOL NetFind. The range of content, features, and tools offered on the AOL service includes the following:

—Online Community—America Online promotes interactive community through electronic mail services, public bulletin boards, the Buddy List feature (for members to keep an up-to-the moment account of whether fellow members are online, subject to a blocking feature), the AOL Instant Messenger service, which allows members to communicate online instantaneously without having to access an electronic mailbox, an online community center, public or private "meeting rooms" and interactive conversations (chat). Guest interviews, with participation by members, take place at live "auditorium" events.

—Channel Line-Up—Content on the AOL service is organized into channels, allowing members to navigate the service easily to find areas of interest. Each of the following nineteen channels offers informational content and commerce and community opportunities: AOL Today, News, Sports, Influence, Travel, International, Personal Finance, WorkPlace, Computing, Research & Learn, Entertainment, Games, Interests, Lifestyles, Shopping, Health, Families, Kids Only and Local. Content providers on the AOL service include CBS News, Hachette Filipacchi Magazines, Bloomberg, The New York Times and Business Week.

—Personalization and Control Features—Members can personalize their experience on the AOL service through a number of features and tools, including a reminder service that sends e-mail in advance of important events, stock portfolios that automatically update market prices, Mail Controls, which allow members to limit who may send them e-mail and to block certain types of e-mail, Favorite Places, which allows members to mark particular Web sites or AOL areas, and Portfolio Direct and News Profiles, which send stories of particular interest to members. The AOL service offers Parental Controls to help parents form their children's online experience, including tools that limit access to particular AOL areas or Web sites or to certain features (for example, the AOL Instant Messenger service, sending or receiving files attached to e-mail or embedded pictures in e-mail, or access to premium services). The Marketing Preferences feature enables members to elect not to receive certain marketing offers.

Later this year the Company plans to introduce its latest version of the AOL service software, AOL 5.0. New features to the service will include "You've Got Pictures," "My Calendar," AOL Search and AOL Plus. "You've Got Pictures," which began testing in June 1999, will allow members to receive their developed photos online, share the photos with others via e-mail, organize and store photos online and order reprints and gifts. "My Calendar" will be an interactive desktop calendar that includes features that enable members to track appointments, key dates and other personal events online. AOL 5.0 will feature AOL

Search, a new search product that will enable AOL members to search the Internet and AOL's exclusive content without leaving the AOL service. The service will also include AOL Plus, a feature that will enable members to connect to the AOL service through high-speed broadband technologies, including DSL, cable, satellite and wireless and will provide additional online content to members connecting through such broadband technologies. The expanded content will include video, games, music and online catalogue shopping features.

The CompuServe Service

The CompuServe service, with approximately 2 million members, targets the value-oriented portion of the U.S. market and the professional business-oriented market outside of the U.S. It is available in over 500 cities worldwide, including in the U.S., Canada and Europe. This fiscal year the CompuServe service launched CompuServe 2000, new software that provides faster Internet connections, easier installation and registration, expanded customer options, more powerful e-mail features and simpler navigation. CompuServe also launched a Web site, CompuServe.com, to serve as an Internet gateway for its members. Features on the site include personalized news, updated weather, favorite links and Web centers highlighting specific areas of interest. CompuServe has created a Custom Solutions Division to develop and create co-branded and custom versions of the CompuServe 2000 software. The Custom Solutions Division will also offer private label Internet solutions for strategic partners.

The Netscape Netcenter

The Company's Netscape Netcenter Web site (http ww.netscape.com) has more than 17 million registered users and offers a variety of products and services, including news and information, opportunities to purchase goods and services, Internet site directories, software, software downloads, and product and technical support information. Netcenter's services consist of search and navigation services, such as the aggregated NetSearch area, which helps consumers and businesses find relevant information, and SmartBrowsing; programming channels, such as Lifestyles, Personal Finance or Small Business, which organize content and services for directed broadcast; communications and community services such as e-mail and bulletin board services, which help consumers and businesses connect and communicate; personalization services, such as My Netscape Channel, a personalized topical channel that users can customize to their personal interests; Customer Netcenter, which enables businesses to create their own portals; and opportunities for electronic commerce. Netcenter also offers services such as: Site Central, a free Web site building service, Netscape Sports Channel, Delivery Channel by FedEx and the My Netscape Network. Netcenter also promotes the Company's software and customer solutions by featuring descriptions of the Company's offerings and providing downloads of certain software products. Netcenter includes a co-branded version of the Company's AOL Instant Messenger service and its "Local" channel features content provided by the Company's Digital City property.

The AOL.COM Web Site

The Company's AOL.COM Web site (http://www.AOL.COM) offers Internet users (who may not be AOL members) content, features and tools, including AOL NetFind, an Internet search and rating tool, and the AOL Instant Messenger service, which allows Internet users to communicate in real-time with their friends and family. AOL.COM also offers AOL members the opportunity to exchange e-mail on the Internet, without signing onto the service, through AOL NetMail, and My News, a personalized news service. Content provided on the AOL.COM site includes news, shopping, Web search services, classified advertisements, and white and yellow pages directories. The Company plans to continue to expand content and services available through the AOL.COM Web site.

AOL Instant Messenger (AIM)

The Company's AOL Instant Messenger (AIM) service is a Web-based communications service that enables Internet users to know when other users of the service are online and to send and respond in real time to private personalized electronic text messages. When an instant message is sent via AIM, the message pops up on the receiver's screen instantly. The AIM service had over 25 million registered users as of June 30, 1999. The AIM service is free, and available for downloading on AOL.COM and on a co-branded basis on the Company's other brands and services, including the CompuServe service, CompuServe.com, Netscape Netcenter and to users of Netscape Communicator software. The Company has also announced arrangements to develop co-branded versions of the AIM service with Apple Computer, Inc., Mindspring Enterprises, Inc., Earthlink Network and Juno Online Services, Inc. Version 2.0 of the AIM service offers such features as the ability to search the Web and yellow and white pages directory features directly from the AIM service and access to news and information; a "File Transfer" feature that allows users to share files with other AIM 2.0 users; and a directory of chat and interest areas.

Netscape Communicator

Netscape Communicator is a suite of open HTML-based client software that integrates browsing, e-mail, Web-based word processing and group scheduling. This suite of software enables users to communicate, share and access information. Netscape Navigator, the browser that serves as the core component of Netscape Communicator, allows access to information and network applications on intranets, extranets and the Internet. Netscape Navigator offers a point-and-click graphical user interface that allows users to browse the Internet's array of network resources and participate in commerce across extranets and the Internet. Two versions of the Netscape Communicator are marketed: Netscape Communicator and Netscape Communicator with Calendar. The latest version, Communicator 4.6, was released in May 1999 and offers several new features, including the Company's SmartBrowsing technology and streaming audio and visual capabilities for consumers. With the SmartBrowsing technology consumers can search Netcenter services and connect to Web sites covering a variety of topics by entering common words or topics (Netscape Internet Keywords) into the browser location bar.

Interactive Properties Group

The Interactive Properties Group includes and oversees the Company's branded properties that operate across multiple services or platforms, such as Digital City, ICQ and MovieFone. The group is also responsible for developing new distribution networks that will enable the Company to build or acquire branded properties that operate across the Company's multiple services and platforms while benefiting from the Company's common infrastructure.

Digital City

The Company's subsidiary, Digital City, Inc., which is owned in part by the Tribune Company, is a local online content network that offers a network of local content and community guides in over 60 U.S. cities, including Atlanta, Boston, Chicago, Dallas, Denver, Detroit, Los Angeles, Minneapolis, New York, Orlando, Philadelphia, San Diego, San Francisco and Washington, D.C. Local content provided by Digital City includes original and third-party news, sports, weather, a local guide service with directory and classified listings and an interactive forum. Digital City provides local interactive content and services on the AOL service, AOL.COM, the CompuServe service, CompuServe.com, Netscape NetCenter, ICQ and on the Worldwide Web (http://www.digitalcity.com). Digital City also is available through other distribution vehicles. For example, Digital City has an agreement with MCI Worldcom to become the local content provider on MCI Worldcom Internet, offering its interactive city guides to its Internet subscribers.

ICQ

The Company's subsidiary, ICQ Ltd., is an Internet-based communications Web portal site, which utilizes the ICQ ("I seek you") instant communications and chat technology. The portal site is located at http://www.icq.com. At the end of fiscal 1999, ICQ had nearly 38 million registered users, and was being used actively by almost 15 million users. More than 7.5 million people use ICQ everyday, with more than 1 million simultaneous users. Users become aware of ICQ through the "word of mouth" equivalent on the Internet of invitations from current ICQ users to potential users via e-mail. ICQ has international appeal and presence and is used primarily by young, knowledgeable users. ICQ has introduced its latest software, 99a, which brings new tools to the desktop, including ICQiT!, a built-in suite of intuitive search tools, and the new ICQ NOW! content and community area. The Company acquired the ICQ technology with its focus on interactive community and constant desktop presence, and is developing it into an all-service Web portal that maintains its desktop presence.

AOL MovieFone

The Company acquired MovieFone, the largest movie guide and ticketing service in the country, in May 1999. Through its interactive telephone service and its online service, MovieFone.com, MovieFone provides millions of moviegoers each week with a complete free directory of movies, showtimes and theater locations, and also provides them the ability to purchase tickets. The Company intends to use MovieFone to enhance the online entertainment information available across its family of brands and to provide special events and features for subscribers to and users of its interactive services and products.

Spinner.com, Winamp and SHOUTcast

The Company acquired several Internet music brands in May 1999 through its acquisitions of Spinner Networks Incorporated and Nullsoft, Inc. The Spinner.com Web site offers over 100 channels of programmed music in various formats. Its content includes over 175,000 songs, and its music players display song information as the song is played. The music players also provide links that enable real-time listener feedback and instant ordering of the music being played. Nullsoft, Inc. is the developer of Winamp, a branded MP3 player for Windows, and SHOUTcast, an MP3 streaming audio system. The SHOUTcast streaming audio system enables individuals to broadcast their own content over the Internet. The Company plans to make these music features available to consumers across its brands, as well as to customize them for the audience and partners of the Company's brands.

AOL International Group

The AOL International Group oversees the AOL and CompuServe services and operations outside the United States, as well as the Netscape Online service, which will be launched soon in the United Kingdom. As of August 1999, the AOL and CompuServe services had more than 3 million members outside the United States. The Company offers its AOL and/or CompuServe branded services through joint ventures or distribution arrangements in Australia, Austria, Canada, France, Germany, Japan, the Netherlands, Sweden, Switzerland and the United Kingdom. Globally, members are able to access these services in over 100 countries. Additionally, the Company is in the process of expanding the number of countries to which it offers local services. The Company's international strategy is to provide consumers with local services in key international markets featuring local language, content, marketing and community.

Central to the Company's strategy has been the formation of strategic alliances with strong international partners and the provision of access for all members of international services. In addition, U.S. and global subscribers to the AOL service can access selected content and communities offered on the Company's other global services. The Company, through joint ventures with Bertelsmann AG entitled "AOL Europe" and "CompuServe Europe," provides the AOL service and/or the CompuServe service in several European countries and plans to extend these services into additional European markets. Bertelsmann, one of the world's largest media companies, is a minority stockholder in the Company with an approximately 1.3% stake, and Dr. Thomas Middelhoff, Bertelsmann's Chairman, is a member of the Company's Board of Directors.

The Company continues to update its services to match the needs of its international markets. For example, in June 1999, AOL Europe introduced an unlimited use, flat-rate monthly pricing plan in the United Kingdom, and in July 1999, AOL Europe announced plans to launch Netscape Online, a new subscription free service, in mid-August 1999. The Netscape Online service will compete in the emerging subscription-free value market in the United Kingdom and will complement the existing AOL and CompuServe services.

During the past fiscal year, the Company has also taken steps to launch services in several new foreign markets:

- **Australia**: The AOL Australia service was launched in October 1998 through a joint venture between the Company and Bertelsmann AG. AOL Australia features exclusive local Australian content and also offers members access to the original content available on the international services.

- **Hong Kong**: An AOL-branded service for Hong Kong consumers is expected to be launched in the fall of 1999. The AOL Hong Kong service will provide original local content in both Chinese and English, with most local content being developed or provided by China Internet Corporation Limited ("CIC"), a Hong Kong based company that has entered into a distribution arrangement with the Company. In June 1999, the Company acquired an equity interest in the former wholly-owned subsidiary of CIC, China.com, an Internet company and affiliate of CIC that operates Web portals throughout greater China. The Company intends to use its investment in China.com to expand its commitments in the region. A Web site, AOL.COM.HK, is currently available in either the English or Chinese language. The Web site includes both a co-branded AOL Instant Messenger service and the AOL Netfind feature with either English or Chinese language search capabilities.

- **Latin America**: In December 1998, the Company announced the formation of a joint venture with the Cisneros Group of Companies ("Cisneros Group") to bring the Company's services to consumers in Latin America. In June 1999, the Brazilian subsidiary of the joint venture launched the BR.AOL.COM Web site. The joint venture expects to launch an Internet online service, AOL Brasil, by the end of 1999. The joint venture plans to launch services in Mexico and Argentina in 2000, with other markets to be added in the future. The joint venture will also be responsible for the development of the CompuServe brand in Latin America.

Advertising and Commerce

An important component of the Company's strategy in its Interactive Online Services business is to increase revenues from advertising and commerce sources and from the sale of merchandise. The Company continues to establish a wide variety of relationships with advertising and commerce partners to grow and diversify its non-subscription based revenues and to provide subscribers on the Company's interactive services with access to a broad selection of competitively priced, easy-to-order products and services. The Company has worked to develop multiple revenue sources for its interactive properties and services, and to broaden the scope of those revenue sources beyond subscriptions and advertising fees to include revenues from additional sources, such as transaction fees and licensing fees. The Company has also expanded the scope, range and types of businesses involved in advertising and commerce relationships. The Company has entered into advertising arrangements that encompass multiple brands within the Company's family of brands. Additionally, the Company has renewed and extended or expanded relationships with existing advertising and commerce partners.

The Company offers its advertising and commerce partners a variety of customized programs, which may include guaranteed numbers of impressions and select sponsorship of particular online areas or Web pages for designated time periods. As merchants recognize the value in reaching the Company's large, growing and active subscriber base and users of its Web-based properties, the Company has been able to earn additional revenues by offering selected merchants exclusive rights to market particular goods or services within one or more of the Company's online services and properties. In those transactions, the Company provides its commerce partners certain marketing and promotional opportunities and in return receives cash payments, the opportunity for revenue sharing, cross-promotions and competitive pricing and online conveniences for subscribers. Certain of the transactions with partners also include an equity component for the Company. The Company may receive a warrant to purchase stock or may purchase or acquire a direct equity interest in the partner. These equity investments are accounted for in accordance with Company accounting policies and certain of these equity investments may result in revenue generation at the onset of the deal. In addition, these equity investments can also represent an additional potential source of income to the Company upon their disposition.

The advertising and commerce partnerships also provide the users of the Company's interactive services and properties with access to a diverse selection of consumer products and services. The Company obtains revenues from the sale of merchandise by offering for sale to subscribers on its interactive services a number of computer and Internet online goods and services, including hardware and software products and books and Company logo merchandise. The Company promotes its merchandise principally by means of promotional "pop-up" screens and makes its merchandise available in online stores included in various channel stores and in specialized seasonal or other targeted shops.

Network Services

Interactive Online Services Business Technologies

The Company employs a multiple vendor strategy in designing, structuring and operating its network services utilized in its Interactive Online Services business. The Company manages AOLnet, a transfer control protocol/Internet protocol (TCP/IP) network of third party network service providers, including Sprint Corporation, GTE Internetworking, formerly BBN Corporation, and MCI WorldCom, Inc.'s wholly-owned subsidiary MCI Worldcom Advanced Networks, Inc. AOLnet is used for the AOL service and certain versions of the CompuServe service in North America.

The Company anticipates continuing to build AOLnet in order to increase its network capacity, provide members of its online services with higher speed access and reduce data network costs on a per-hour basis. During fiscal 1999, the Company added modems at a rate of approximately 37,500 monthly to expand to approximately 1.25 million modems. The AOL service grew as of July 1999 to achieve over 1.14 million simultaneous users, the exchange of approximately 66 million e-mail messages a day and 468 million Instant Message communications a day. AOLnet offers members of the AOL service in North America local telephone numbers in approximately 1,000 cities. In total, the AOL service is available in approximately 1,500 cities in more than 100 countries.

The CompuServe service for versions prior to CompuServe 2000 currently relies on data network services provided pursuant to a Network Services Agreement among the Company and CompuServe Incorporated, a wholly-owned subsidiary of MCI

WorldCom. The agreement has an initial term ending December 31, 2002, subject to possible extension by the Company under certain circumstances. Under the agreement, the Company has made certain commitments to use such network services for these versions of the CompuServe service. The smooth operation of and access capacity on these versions of the CompuServe service are dependent on the network services provided under the agreement and would be adversely affected by service failures of the network services provider. The CompuServe service is available in over 500 cities worldwide.

The Company's ability to reduce data network costs on a per-hour basis and to expand the network capacity may be limited or impaired under certain circumstances. The Company enters into multiple-year data communications agreements to support AOLnet. In connection with those agreements, the Company may commit to purchase certain minimum data communications services or to pay a fixed cost for the network services. Accordingly, if the number of subscribers or usage significantly decreases, network costs will not correspondingly decrease.

Subscribers to the Company's interactive online services may experience difficulty in accessing their service from local access numbers from time to time due to changing patterns of usage or peaks in usage in particular geographic areas. In addition, supply shortages exist from time to time for local exchange carrier lines from local telephone companies that the Company requires to expand network capacity. The expansion of AOLnet requires a substantial investment in telecommunications equipment, which the Company is financing principally through leasing. Supply shortages or the failure to obtain the necessary financings for the buildout of AOLnet could impair the Company's ability to expand network capacity.

Service Platforms and Access Devices

The Company supports a variety of software platforms, hardware devices and conduits for access to the Company's interactive online services. Today, the vast majority of members and users of interactive online services access such services through personal computers. Software platforms that the AOL and CompuServe services are available on include primarily the Windows (3.1, 95 and 98) and Macintosh operating systems. The Company has established its "AOL Anywhere" strategy of making the AOL service and features available through multiple connections and multiple devices. The Company intends to make its interactive online services available on new and future platforms or devices, such as televisions, wireless telephones, hand-held or pocket devices, online appliances, and smart phones, as consumer demand and technology and commercial viability permit. The Company is developing versions of its interactive online software that are customized for use on the various platforms. Features that may be made available on the different platforms include e-mail, news, stock quotes, electronic commerce and instant messages. The Company's next generation software for the AOL service, AOL 5.0, which will be introduced in the fall of 1999, will include the new feature AOL Plus, which will enable members to connect to the AOL service through high-speed broadband technologies, including DSL, cable, satellite and wireless, and will provide additional online content to members connecting through such broadband technologies. The expanded content will include video, games, music and online catalogue shopping features.

The Company already has taken steps under this strategy to broaden the platforms and devices on which services or features of its services can be accessed. For example, in June 1999, the Company and 3Com Corporation announced a strategic relationship to give AOL service members access to their e-mail via a handheld computer and to work to provide additional features of the AOL service on the handheld platform. In addition, the Company has continued development work related to AOL TV, an enhanced interactive television Internet service. In May 1999, the Company announced arrangements with four partners, DIRECTV, Inc., Hughes Network Systems, Phillips Electronics and Network Computer, Inc. (now known as Liberate Technology, Inc.), related to the development of different components of the AOL TV service, including the design and manufacture of set top boxes used in the service, the software platform for the service and collaboration on combining digital satellite television programming with the service. The Company also has a license from Gemstar International Group Limited to use Gemstar's technology and intellectual property to develop and deploy electronic programming guides for the AOL TV service.

In June 1999, the Company formed a strategic alliance with Hughes Electronics Corporation ("Hughes"), a subsidiary of General Motors Corporation ("General Motors"), to develop and market integrated digital entertainment and Internet services. The alliance will extend the reach of the Company's AOL TV interactive television and its AOL Plus high-speed Internet services. The alliance, which builds on an earlier agreement to develop a combination set-top receiver for DirecTV and AOL TV, provides for extensive cross-promotion and marketing. It also provides for the delivery of AOL Plus to members via Hughes' DirectPC satellite Internet network beginning next year, as well as delivery over Hughes' next generation satellite system for two-way, broadband connectivity. In connection with the alliance, the Company made a $1.5 billion investment in Hughes in the form of a General Motors preference stock, which carries a 6-1/4% coupon rate and has a mandatory conversion into General Motors Class H common stock (GMH) in three years. For additional information regarding this investment, see "Liquidity and Capital Resources" under Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The Company has upgraded AOLnet to support the v.90 standard for high-speed access at 56 kps. and is also investing in the development of alternative technologies to deliver its interactive online services, including cable modems, Digital Subscriber Line (xDSL) access, satellite and wireless technologies. The Company plans to offer its members higher-speed options when they become easy-to-use and commercially viable for the mass market. The Company has formed strategic alliances with each of Bell Atlantic, SBC Communications, Ameritech Corp. and GTE Corp. to use new DSL technology to make available a high-speed upgrade connection to subscribers, with the initial roll out beginning in the summer of 1999. By the end of 1999, the Company expects to offer a high-speed broadband upgrade to serve more than 70 percent of AOL members and will cover nearly 16 million homes. The Company also has entered into an agreement with Compaq under which new Compaq Presario Internet PCs will be equipped with DSL-ready modems and will feature pre-installed AOL software that will enable users to access features available through broadband.

Marketing

The Company's marketing efforts and activities in its Interactive Online Services business are conducted for its multiple brands through a common infrastructure. The marketing goals of the Company's Interactive Online Services business are to attract and retain members or users, as applicable, of the online services and properties and to develop and differentiate the Company's family of brands. To support member acquisition, the Company markets its products and services through a broad array of programs and strategies, including broadcast advertising campaigns, direct mail, magazine inserts and advertisements, co-marketing, bundling agreements and alternate media. The Company also actively markets its multiple brands through traditional campaigns (broadcast television, radio and print publications), and through more innovative means, such as through extensive online and offline cross-promotion and co-branding with a wide variety of interactive services partners. Additionally, through bundling agreements, the Company's interactive online services are on a range of computers made by major personal computer manufacturers. The multi-year agreements provide that pre-installed software will be available by clicking on an icon during the computer's initial setup process. Through an agreement with Microsoft Corp., the AOL service is accessible via a desktop folder on the Windows 95 and 98 operating systems (and will be available on future versions of the Windows operating system through the term of the agreement).

The Company utilizes targeted or limited promotions and marketing programs and pricing plans designed to appeal to particular groups of potential users of its interactive online services and to distinguish and develop its different brands. For example, in connection with the positioning of the CompuServe service in the United States as a value-oriented brand, in June and July 1999 the Company announced marketing initiatives for its CompuServe service with two computer manufacturers and a number of additional retailers. Under these promotions, consumers signing up for three-year memberships to the CompuServe 2000 service at $21.95 per month will receive a rebate of $400 in connection with the purchase of designated models of computers. This promotion is designed to appeal to consumers who are purchasing computers for the primary purpose of getting online and to make the purchase of a personal computer and Internet access easier and more affordable.

The Interactive Online Services business utilizes specialized retention programs designed to increase member and user loyalty and satisfaction. These retention programs include regularly scheduled online events and conferences; the regular addition of new content, features and software programs; and online promotions of upcoming online events and new features. The Company also provides a variety of support mechanisms such as online support and 24-hour telephone customer support services.

Enterprise Solutions Business

Products and Services

The Netscape Enterprise Group is the primary product group in the Enterprise Solutions business of the Company. In addition, the Company has formed Netscape Business Solutions to sell AOL and Netscape products and services to business partners and other companies.

Netscape Enterprise Group

The Netscape Enterprise Group provides enterprise software and services to businesses that assist them in providing services to customers in the electronic commerce markets. The Netscape Enterprise group develops, markets, sells and supports a broad suite of enterprise software, which consists of electronic commerce infrastructure and electronic commerce applications targeted primarily at corporate intranets and extranets, as well as the Internet. The software allows users to share information, manage networks and take their businesses online. The software is based on industry-standard protocols that can be deployed across a variety of operating systems, platforms, databases and interconnected with traditional client/server applications. The Netscape Enterprise Group also provides a variety of services to support its software products, including technical support, professional services and training. Following the merger with Netscape in March 1999, the Netscape Enterprise Group began contributing to the Company's strategic alliance with Sun Microsystems, Inc. (see below).

Electronic Commerce Infrastructure

The Electronic Commerce Infrastructure is a group of solutions for enterprise customers and Internet Service Providers that provide a flexible, scalable foundation on which the customers can build and manage their own extranet or Internet applications or use the Electronic Commerce Applications. The Electronic Commerce Infrastructure provides a services-ready platform through such solutions as a directory and security service for managing users and applications, an application server for building and deploying applications, and a messaging solution for hosting and delivering communications services such as e-mail and unified messaging.

Electronic Commerce Applications

The Netscape CommerceXpert product family of electronic commerce applications enable businesses to link and manage online trading communities of suppliers, distributors, and customers of all sizes and degrees of technical sophistication. The Netscape CommerceXpert solutions are based on the same open protocols and scalable security architecture used for communications on the Internet. These solutions enable organizations to create more secure Internet commerce sites and exchange information with trading partners.

Sun Alliance

In November 1998, the Company entered into a strategic electronic commerce alliance with Sun, which is now referred to as the Sun-Netscape Alliance. In combination with dedicated resources from Sun, the Netscape Enterprise Group operates the Company's part of the alliance. The alliance builds and markets on a collaborative basis end-to-end electronic commerce solutions to help business partners and other companies put their businesses online. The alliance product portfolio provides customers with scalable, integrated infrastructure software and a family of production-ready electronic commerce applications. Products will be offered on the industry's most widely available computing platforms. The infrastructure product portfolio includes: messaging (e-mail) and calendar, collaboration, Web, application, directory (network phone book) and certificate (security) servers. The alliance offers a family of production-ready applications for electronic commerce, including commerce exchange, procurement, selling and billing applications intended to make electronic commerce more efficient. The alliance initially will market and provide existing products from each of Sun and the Netscape Enterprise Group and then will include collaboratively developed products. The alliance has a dedicated sales force that sells the full suite of products on multiple platforms. Support and integration services are also provided.

Marketing

The Company's marketing efforts and activities in its Enterprise Solutions line of business are conducted primarily through joint marketing efforts of the Sun-Netscape Alliance. The marketing goals of the Company's Enterprise Solutions business are to position the Sun-Netscape Alliance as the leading provider of electronic commerce applications and Internet infrastructure software to power the Net economy. The Sun-Netscape Alliance has announced that it will develop, market and sell the products and systems through the alliance using the brand name "iPlanet."

The marketing programs of the Company's Enterprise Solutions business focus on reaching corporate decision makers in its key markets. Advertising will focus on the Sun-Netscape Alliance's leadership position in the industry, and the breadth and innovation of the iPlanet product portfolio. Advertising media will include the Company's interactive online services and properties, traditional print and broadcast advertising campaigns and bundling agreements. A dedicated sales force also markets the products and services sold or provided through the Sun-Netscape Alliance directly to potential customers.

The Enterprise Solutions business utilizes customer marketing programs designed to increase customer loyalty, customer value over time and customer satisfaction. These programs include the recently announced iPlanet Customer Program featuring a secure customer extranet and specialized joint marketing activities, a new customer quality initiative and customer support and services.

Employees

As of June 30, 1999, the Company had approximately 12,100 employees. America Online believes that its relations with its employees are good. None of the Company's employees are represented by a labor union and the Company has never experienced a work stoppage.

Proprietary Rights

The Company relies upon a combination of contract provisions and patent, copyright, trademark and trade secret laws to protect its proprietary rights in its products and services. The Company distributes its products and services under agreements that grant members, users or customers a license to use its products and services and relies on the protections afforded by the copyright laws to protect against the unauthorized reproduction of its products. To license its products, the Company relies in part on "shrink wrap" licenses that are not signed by the end-user and, therefore, may be unenforceable under the laws of certain jurisdictions. In addition, the Company attempts to protect its trade secrets and other proprietary information through agreements with employees and consultants. The Company has also filed for a number of patents for technology relating to the Internet and online industry. Although the Company intends to protect its rights vigorously, there can be no assurance that these measures will be successful. Policing unauthorized use of the Company's products and services is difficult and the steps taken may not prevent the misappropriation of the Company's technology and intellectual property rights. In addition, effective patent, trademark, trade secret and copyright protection may be unavailable or limited in certain foreign countries.

The Company seeks to protect some of the source code of its products as a trade secret and as an unpublished copyright work. Source code for certain products has been or will be published in order to obtain patent protection or to register copyright in such source code. Other source code has been distributed under open source code licenses. The Company has obtained federal trademark registration of a number of marks, including America Online, AOL, Buddy List, Netscape, Netscape Navigator; AOL's triangle design logo; and Netscape's "N" logo and ship's wheel logo, and has trademark rights in the U.S. and abroad in many other proprietary names including, AOL.COM, Digital City, ICQ, AOL Instant Messenger, AOLnet, Netscape Netcenter, "You've Got Mail" and CompuServe.

The Company believes that its products, trademarks and other proprietary rights do not infringe on the proprietary rights of third parties. From time to time, however, the Company has received communications from third parties asserting that features, contents or names of certain of its services or products may infringe patents, copyrights, trademarks and other rights of such parties. No litigation is pending in this area that would have a material adverse effect on the Company's ability to develop, market and sell its products or operate its services. There can be no assurance that third parties will not assert infringement claims against the Company in the future with respect to current or future features or contents of services or products or that any such assertion may not result in litigation or require the Company to enter into royalty arrangements. Third parties also challenge the Company's marks from time to time and such challenges may result in limitation or loss of trademark rights to such proprietary marks.

Regulatory Environment; Public Policy

In the United States and most countries in which the Company conducts its major operations, the Company is not currently subject to direct regulation other than pursuant to laws applicable to businesses generally, including businesses operating in the Internet. Adverse developments in the legal or regulatory environment relating to the interactive online services and Internet industry in the United States, Europe, Asia or elsewhere could have a material adverse effect on the Company's business, financial condition and operating results. A number of legislative and regulatory proposals from various international bodies and foreign and domestic governments in the areas of telecommunications regulation, particularly related to the infrastructures on which the Internet rests, access charges, encryption standards and related export controls, content regulation, consumer protection, advertising, intellectual property, privacy, electronic commerce, and taxation, tariff and other trade barriers, among others, are now under consideration. The Company is unable at this time to predict which, if any, of such proposals may be adopted and, if adopted, whether such proposals would have a beneficial or an adverse effect on the Company's business, financial condition and operating results. The Company has supported certain proposals designed to enhance market access and competition in the offering of both narrowband and broadband Internet services in the United States and in foreign markets and believes that the adoption of such proposals would have a beneficial effect on the development of the Internet medium and of the Company's prospects. The Company is unable, at this time, to predict whether any such proposals will be adopted.

Moreover, the manner in which existing domestic and foreign laws (including Directive 95/46/EC of the European Parliament and of the European Council on the protection of individuals with regard to the processing of personal data and on the free movement of such data) will or may be applied to online service and Internet access providers is uncertain, as is the effect on the Company's business given different possible applications. Similarly, the Company is unable to predict the effect on the Company from the potential future application of various domestic and foreign laws governing content, export restrictions, privacy, consumer protection, export controls on encryption technology, tariffs and other trade barriers, intellectual property and taxes.

The Company actively works both in the United States and internationally with industry groups and alliances, as well as public interest groups and representatives of government on issues affecting the interactive media, including issues such as privacy measures and policies, obscenity and pornography, consumer protection, taxation of interactive services and use, regulation of means of access to the Internet and intellectual property issues such as the application of copyright laws to the interactive medium. For example, the Company is a member of the openNet Coalition, a coalition of industry leaders promoting open access to broadband technologies; the Internet Alliance and the NetCoalition.com, Internet industry associations; and the Online Privacy Alliance formed to address privacy issues in the interactive medium and is a member of the steering committees of TRUSTe and BBB Online, each of which is developing enforcement systems for private sector commitments to fair information practice principles.

The Company believes that industry-led standards to address issues facing the interactive medium will result in workable solutions without restricting the further development of the medium. The Company seeks to educate representatives of industry, government and public interest groups on the benefits to society of the new interactive services medium and of the greater likelihood of society's achieving those benefits through the independent industry-led and market driven approaches outlined above. In the Company's view, such an approach will provide a greater acceptance of the medium by consumers around the world and a more favorable environment for the acceptance of the Company's products and services. Some of the issues the Company is focusing on are the protection of privacy, online tools to permit user choice of content, prosecution of online crimes, safeguarding of children, enhancement of online security, education and learning, online community activities, fostering citizen and parental education and involvement and protection of intellectual property. The Company has adopted internal policies and principles regarding these areas and has implemented features in its services, such as its Parental Controls feature, chat safety tips posted prominently on the Kids Only channel of the AOL service, and the Notify AOL feature that enables members to report inappropriate activity on the AOL service, as further support for its standards. The Company is unable at this time to predict whether this approach will be adopted by government and whether the positive regulatory environment being sought by this approach will be forthcoming.

Available Information

The Company files annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission. Any document the Company files with the Commission may be read or copied at the Commission's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the Commission at 1-800-SEC-0330 for further information on the public reference room. The Company's Commission filings are also available to the public at the Commission's Web site at http://www.sec.gov.

Item 2. Properties

The Company maintains facilities and offices at various locations throughout the United States and the rest of the world for general corporate purposes, including technology centers, customer call centers, office space and headquarters.

America Online maintains its headquarters facilities in Dulles, Virginia, and holds various properties at and near the headquarters facilities that are used principally in its Interactive Online Services business. The Company leases office space in the following locations for Customer Call Centers: Tucson, Arizona; Jacksonville, Florida; Albuquerque, New Mexico; Oklahoma City, Oklahoma; Ogden, Utah; and the Philippines. The CompuServe service has its primary operations in Columbus, Ohio, and has various properties at and near those facilities. Digital City leases office space in the United States cities for which it provides local interactive content and services. MovieFone leases office space in New York City, but is moving its operations to leased office space in Westchester, New York. ICQ maintains its operations in Israel. The Enterprise Solutions business has its primary operations in Mountain View, California, and has various other properties throughout the United States and in other countries.

The following table sets forth information on the Company's material properties:

Location	Size	Owned/Lease	Purpose
Columbus, OH	296,000 sq. ft.	Owned	Office Space
Dulles, VA	590,000 sq. ft.(1)	Owned (2)	Corporate Headquarters
Dulles, VA	180,000 sq. ft.	Owned	Technology Center
Manassas, VA	220,000 sq. ft.	Owned	Technology Center (3)
Mountain View, CA	1,054,000 sq. ft.	Leased	Office Space
Reston, VA	265,000 sq. ft.	Owned (2)	Technology Center
San Francisco, CA	35,000 sq. ft.	Leased	Office Space
Vienna, VA	110,000 sq. ft.	Leased	Office Space

(1) Two additional facilities are under construction at this site that, when completed, will add 380,000 sq. ft. to the current size. Both facilities are expected to be completed in 2000.
(2) This property is held subject to a mortgage.
(3) The Company acquired 25.5 acres of land in Manassas, Virginia in February 1999. The technology center to be located on the property is under construction and is expected to be completed in early 2000.

Item 3. Legal Proceedings

The Company is a party to various litigation matters, investigations and proceedings, including a shareholder derivative suit filed in Delaware chancery court against certain current and former directors of the Company alleging violations of federal securities laws. The Company has settled the shareholder derivative suit and obtained the approval of the Delaware chancery court on terms that will not have a material adverse effect on the financial condition or results of operations of the Company.

The Department of Labor ("DOL") is investigating the applicability of the Fair Labor Standards Act ("FLSA") to the Company's Community Leader program. The Company believes the Community Leader program reflects industry practices, that the Community Leaders are volunteers, not employees, and that the Company's actions comply with the law. The Company is cooperating with the DOL, but is unable to predict the outcome of the DOL's investigation. Former volunteers have sued the Company on behalf of an alleged class consisting of current and former volunteers, alleging violations of the FLSA and comparable state statutes. The Company believes the claims have no merit and intends to defend them vigorously. The Company cannot predict the outcome of the claims or whether other former or current volunteers will file additional actions.

The costs and other effects of pending or future litigation, governmental investigations, legal and administrative cases and proceedings (whether civil or criminal), settlements, judgments and investigations, claims and changes in those matters (including those matters described above), and developments or assertions by or against the Company relating to intellectual property rights and intellectual property licenses, could have a material adverse effect on the Company's business, financial condition and operating results. Management believes, however, that the ultimate outcome of all pending litigation should not have a material adverse effect on the Company's financial position and results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

Not Applicable.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Market Price of Common Stock

The following table sets forth the range of high and low sale prices for the Company's Common Stock for the periods indicated and reflects all stock splits effected by the Company:

For the quarter ended:	High	Low
September 30, 1997....	$ 10.26	$ 7.06
December 31, 1997.....	$ 11.41	$ 8.00
March 31, 1998........	$ 17.47	$10.31
June 30, 1998.........	$ 27.41	$17.31
September 30, 1998....	$ 35.13	$17.50
December 31, 1998.....	$ 80.00	$20.66
March 31, 1999........	$153.75	$67.00
June 30, 1999.........	$175.00	$89.50

The Company has never declared, nor has it paid, any cash dividends on its Common Stock. The Company currently intends to retain its earnings to finance future growth and, therefore, does not anticipate paying any cash dividends on its Common Stock in the foreseeable future.

As of July 26, 1999, the approximate number of stockholders of record of Common Stock was 24,600. In addition, there were approximately 1.9 million beneficial holders of the Common Stock, representing persons whose stock is in nominee or "street name" accounts through brokers.

Exchange Information

The Company's Common Stock is traded on the New York Stock Exchange under the symbol "AOL."

Options on the Company's stock are traded on the Chicago Board Options Exchange, the American Stock Exchange, and the Pacific Stock Exchange.

Recent Sales of Unregistered Securities

On May 28, 1999, the Company acquired Spinner Networks Incorporated in exchange for the issuance of approximately 2.4 million shares of Company common stock. The transaction was a private placement and exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

On May 28, 1999, the Company acquired Nullsoft, Inc. in exchange for the issuance of approximately 720,000 shares of Company common stock. The transaction was a private placement and exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

Item 6. Selected Financial Data

	Year Ended June 30,				
	1999	1998	1997	1996	1995
	Amounts in millions, except per share data				
Statement of Operations Data:					
Subscription services	$3,321	$2,183	$1,478	$1,024	$352
Advertising, commerce and other	1,000	542	308	111	50
Enterprise solutions	456	366	411	188	23
Total revenues	4,777	3,091	2,197	1,323	425
Income (loss) from operations	458	(120)	(485)	64	(41)
Net income (loss) (1)	762	(74)	(485)	35	(55)
Income (loss) per common share:					
Net income (loss) per share-diluted	$ 0.60	$(0.08)	$(0.58)	$ 0.04	$(0.09)
Net income (loss) per share-basic	$ 0.73	$(0.08)	$(0.58)	$ 0.05	$(0.09)
Weighted average shares outstanding:					
Diluted	1,277	925	838	944	587
Basic	1,041	925	838	751	587

	As of June 30,				
	1999	1998	1997	1996	1995
	Amounts in millions				
Balance Sheet Data:					
Working capital (deficiency)	$254	$108	$(40)	$72	$18
Total assets	5,348	2,874	1,501	1,271	459
Total debt	364	372	52	25	24
Stockholders' equity	3,033	996	610	707	242

	Year Ended June 30,				
	1999	1998	1997	1996	1995
	Amounts in millions)				
Other Selected Data:					
Net cash provided by operating activities	$1,099	$437	$131	$2	$18
Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (2)	968	302	111	138	11

(1) Net income in the fiscal year ended June 30, 1999, includes special charges of $95 million related to mergers and restructurings, $25 million in transition costs and a net gain of $567 million related to the sale of investments in Excite, Inc. Net loss in the fiscal year ended June 30, 1998, includes special charges of $75 million related to mergers and restructurings, $94 million related to acquired in-process research and development and $17 million related to settlements. Net loss in the fiscal year ended June 30, 1997, includes special charges of $385 million for the write-off of deferred subscriber acquisition costs, $49 million for restructuring, $24 million for contract terminations, $24 million for a legal settlement and $9 million related to acquired in-process research and development. Net income in the fiscal year ended June 30, 1996, includes special charges of $17 million for acquired in-process research and development and $8 million in merger related costs. Net loss in the fiscal year ended June 30, 1995, includes special charges of $50 million for acquired in-process research and development and $2 million for merger expenses.

(2) EBITDA is defined as net income plus: (1) provision/(benefit) for income taxes, (2) interest expense, (3) depreciation and amortization and (4) special charges. For the fiscal years ended June 30, 1997 and prior, EBITDA does not add back the amortization of subscriber acquisition costs. The Company considers EBITDA an important indicator of the operational strength and performance of its business including the ability to provide cash flows to service debt and fund capital expenditures. EBITDA, however, should not be considered an alternative to operating or net income as an indicator of the performance of the Company, or as an alternative to cash flows from operating activities as a measure of liquidity, in each case determined in accordance with generally accepted accounting principles ("GAAP").

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Founded in 1985, America Online, Inc., ("America Online" or the "Company") based in Dulles, Virginia, is the world's leader in interactive services, Web brands, Internet technologies, and electronic commerce services. The Company operates two worldwide subscription based Internet online services, America Online, with more than 18 million members, and CompuServe, with approximately 2 million members; several leading Internet brands including ICQ, AOL Instant Messenger and Digital City, Inc.; the Netscape Netcenter and AOL.COM Internet portals; the Netscape Communicator client software, including the Netscape Navigator browser; AOL MovieFone, the nation's number one movie listing guide and ticketing service; and Spinner Networks Incorporated and Nullsoft, Inc., leaders in Internet music. Through its strategic alliance with Sun Microsystems, Inc., the Company also develops and offers easy-to-deploy, end-to-end electronic commerce and enterprise solutions for companies operating in and doing business on the Internet.

The Company currently has two major lines of businesses organized into four product groups. These groups are supported by a common infrastructure. This organization structure allows the Company to develop and grow multiple revenue streams by utilizing the common infrastructure across the multiple brands it currently has, as well as cost-effectively compete in new and emerging markets.

Interactive Online Services Business

The Interactive Services Group

The Interactive Services Group operates the Company's interactive products: the AOL and CompuServe services and their related brand and product extensions, including AOL Instant Messenger and AOL.COM; Netscape Netcenter; and the Netscape Communicator client software, including the Netscape Navigator browser. This group is also charged with rapidly delivering high-quality, world-class products, features and functionality across all branded services and properties and also has responsibility for broadband development and AOL devices like AOL TV.

The Interactive Properties Group

The Interactive Properties Group operates ICQ, Digital City, MovieFone, Direct Marketing Services ("DMS"), Spinner Networks Incorporated and Nullsoft, Inc., developer of the Winamp and SHOUTcast brands. This group is responsib[illegible] building new revenue streams by seeking out opportunities to build or acquire branded properties that operate across m[illegible] services or platforms.

The AOL International Group

The AOL International Group oversees the AOL and CompuServe services outside of the U.S., as well as the recently announced Netscape Online service. The AOL International Group operates the AOL and CompuServe brands in Europe with its joint venture partner Bertelsmann AG; AOL Canada, a wholly-owned subsidiary of America Online, Inc.; AOL Japan, with its joint venture partners Mitsui and Nikkei; and AOL in Australia with Bertelsmann. America Online plans to launch services in Hong Kong with China Internet Corporation and in Latin America with the Cisneros Group.

Netscape Enterprise Solution Business

The Netscape Enterprise Group

The Netscape Enterprise Group serves Netscape's enterprise customers and contributes to America Online's part of the strategic alliance with Sun. In combination with dedicated resources from Sun, the Netscape Enterprise Group delivers easy-to-deploy, end-to-end solutions to help business partners and other companies put their businesses online.

Competition

The Company competes with a wide range of other companies in the communications, advertising, entertainment, information, media, Web-based services, software, technology, direct mail and electronic commerce fields for subscription, advertising, and commerce revenues, and in the development of distribution technologies and equipment in its Interactive Online Services business. The Company also competes with a wide range of companies in the development and sale of electronic commerce infrastructure and applications in its Enterprise Solutions business.

- Competitors for subscription revenues include:
  - — online services such as the Microsoft Network, AT&T Worldnet and Prodigy Classic
  - — national and local Internet service providers, such as MindSpring and EarthLink
  - — long distance and regional telephone companies offering access as part of their telephone service, such as AT&T Corp., MCI WorldCom, Inc., Sprint Corporation and regional Bell operating companies
  - — cable television companies
  - — cable Internet access services offered by companies such as Excite@Home and Road Runner Group

- Competitors for advertising and commerce revenues include:
  - — online services such as the Microsoft Network, AT&T Worldnet and Prodigy Classic
  - — Web-based navigation and search service companies such as Yahoo! Inc., Infoseek Corporation (to be acquired by the Walt Disney Company), Lycos, Inc. and Excite@Home
  - — global media companies including newspapers, radio and television stations and content providers, such as the National Broadcasting Corporation, CBS Corporation, The Walt Disney Company, Time Warner Inc., The Washington Post Company and Conde Nast Publications, Inc.
  - — cable Internet access services offered by companies such as Excite@Home and Road Runner Group
  - — Web sites focusing on content, commerce, community and similar features such as Amazon.com and eBay

- Competition in the development of distribution technologies and equipment includes:
  - — broadband distribution technologies used in cable Internet access services offered by companies such as Excite@Home and Road Runner Group
  - — advanced telephone-based access services offered through digital subscriber line technologies offered by local telecommunications companies
  - — other advanced digital services offered by broadcast, satellite and wireless companies
  - — television-based interactive computer services, such as those offered by Microsoft's WebTV
  - — personal digital assistants or handheld computers, enhanced mobile phones and other equipment offering functional equivalents to the Company's features

- Competitors in the development and sale of electronic commerce infrastructure and applications include:
  - — providers of electronic commerce infrastructure such as server software, including International Business Machines Corporation, Microsoft Corporation, Oracle Corporation, Novell, Inc., Software.com, Inc., BEA Systems, Inc. and the provider of the Apache Web Server
  - — providers of electronic commerce applications including International Business Machines Corporation, Oracle Corporation, General Electric Information Systems, Microsoft Corporation, PeopleSoft, Inc., SAP A.G., Open Market, Inc., Ariba Technologies, CommerceOne, Sterling Commerce, Inc. and BroadVision, Inc.

Some of the present competitors and potential future competitors of the Company may have greater financial, technical, marketing or personnel resources than the Company. In addition, as a result of acquisitions, certain competitors are able to offer both Internet access and other services, such as cable television or telephone service, and such consolidation may continue. The competitive environment could have a variety of adverse effects on the Company. For example, it could:

- negatively impact the Company's ability to generate greater revenues and profits from sources other than online service subscription revenues, such as advertising and electronic commerce

- limit the Company's opportunities to enter into or renew agreements with content providers and distribution partners
- limit the Company's ability to develop new products and services
- limit the Company's ability to continue to grow or sustain its subscriber base
- require price reductions in the subscription fees for online services and require increased spending on marketing, network capacity, content procurement and product and features development
- require price reductions in the Company's enterprise software products
- result in a loss of the Company's market share in the enterprise software industry
- require an increase in the Company's sales and marketing expenditures

Any of the foregoing events could have an adverse impact on revenues or result in an increase in costs as a percentage of revenues, either of which could have a material adverse effect on the Company's business, financial condition and operating results.

Consolidated Results of Operations

Revenues

The following table and discussion highlights the revenues of the Company for the years ended June 30, 1999, 1998 and 1997.

	Year ended June 30,					
	1999		1998		1997	
	(Dollars in millions)					
Revenues:						
Subscription services	$3,321	69.5%	$2,183	70.6%	$1,478	67.3%
Advertising, commerce and other	1,000	21.0	543	17.6	308	14.0
Enterprise solutions	456	9.5	365	11.8	411	18.7
Total revenues	$4,777	100.0%	$3,091	100.0%	$2,197	100.0%

The Company generates three main types of revenues: subscription services; advertising, commerce and other; and enterprise solutions revenues. Subscription services revenues are generated from customers subscribing to the Company's AOL service and, effective February 1, 1998, the CompuServe service. Advertising, commerce and other revenues are non-subscription based and are generated mainly from businesses marketing to the Company's base of subscribers and users across its multiple brands. Advertising, commerce and other revenues mainly consist of advertising and related revenues, fees associated with electronic commerce and the sale of merchandise. Enterprise solutions revenues consist principally of product licensing fees and fees from technical support, consulting and training services.

Subscription Services Revenues

Currently, the Company's Interactive Online Services business generates subscription services revenue primarily from subscribers paying a monthly membership fee. Prior to December 1, 1996, a significant portion of online service revenues were comprised of hourly charges based on usage in excess of the number of hours of usage provided as part of the monthly fee. With the introduction of flat-rate pricing, as described below, the portion of online service revenues which are generated from hourly charges has decreased substantially.

Effective December 1, 1996, the Company began offering several pricing alternatives to the AOL service in the U.S. aimed at providing a variety of price points designed to appeal to a wide range of consumers. The Company's current pricing options are as follows:

- A standard monthly membership fee of $21.95, with no additional hourly charges (the "Flat-Rate Plan"). Subscribers can also choose to prepay for one year in advance at the monthly rate of $19.95. The Company increased the price of its Flat-Rate Plan from $19.95 per month to $21.95 per month, and the effective monthly rate of the annual plan from $17.95 per month to $19.95 per month, effective at the start of each member's monthly billing cycle in April 1998. Those subscribers who were currently on the annual plan were not subject to an increase until their renewal date. These increases were implemented in order to fund the continued improvement of members' online experience and to keep pace with the cost to the Company of members' increased usage.

- An alternative offering of three hours for $4.95 per month, with additional time priced at $2.50 per hour.

- An alternative offering of $9.95 per month for unlimited use—for those subscribers who have an Internet connection other than through AOL and use this connection to access AOL services.

Prior to December 1, 1996, the Company's standard monthly membership fee for its AOL service in the U.S., which included five hours of service, was $9.95 per month, with a $2.95 hourly fee for usage in excess of five hours per month. Existing members at December 1, 1996, could retain the $9.95 / five hour pricing upon request. For the period July 1, 1996 through November 30, 1996, the Company also offered a pricing plan which included 20 hours of service for $19.95 per month, with a $2.95 hourly fee for usage in excess of 20 hours per month (the "Value Plan"). This plan was discontinued upon the availability of the Flat-Rate Plan on December 1, 1996.

Effective February 1, 1998, the Company offered the following price plans for the CompuServe service:

- A standard monthly membership offering of five hours for $9.95 per month, with additional time priced at $2.95 per hour.
- An alternative offering of $24.95 per month with no additional hourly charge.

During fiscal 1999, the Company launched CompuServe 2000 which utilizes the same platform and infrastructure as the AOL service. This service offered the following price plans:

- A standard monthly membership offering of 20 hours for $9.95 per month, with additional time priced at $2.95 per hour.
- An alternative offering of $19.95 per month with no additional hourly charge.

At June 30, 1999, the Company had approximately 17.6 million AOL brand subscribers, including approximately 15.5 million in North America and approximately 2.1 million in the rest of the world. Also at that date, the Company had approximately 2 million CompuServe brand subscribers, including approximately 1 million in North America and approximately 1 million in the rest of world. At June 30, 1998, the Company had approximately 12.5 million AOL brand subscribers, including approximately 11.2 million in North America and approximately 1.3 million in the rest of the world. Also at that date, the Company had approximately 2 million CompuServe brand subscribers, including approximately 1 million in North America and approximately 1 million in the rest of world.

For fiscal 1999, subscription services revenues increased from $2,183 million to $3,321 million, or 52%, over fiscal 1998. This increase was comprised of an increase in AOL subscription services revenues of $1,020 million, as well as CompuServe subscription services revenues of $118 million, which began in February 1998. The increase in AOL subscription services revenues was primarily attributable to a 38% increase in the average number of AOL North American subscribers for fiscal 1999, compared to fiscal 1998, as well as an 8.2% increase in the average monthly subscription services revenue per AOL North American subscriber. The average monthly subscription services revenue per AOL North American subscriber increased from $17.95 in fiscal 1998 to $19.42 in fiscal 1999. This increase was principally attributable to the increase in the Flat-Rate Plan membership fee from $19.95 to $21.95, which became effective in April 1998.

For fiscal 1998, subscription services revenues increased from $1,478 million to $2,183 million, or 48%, over fiscal 1997. This increase was comprised of an increase in AOL subscription services revenues of $637 million, as well as CompuServe subscription services revenues of $88 million, which began in February 1998, partially offset by a $20 million decrease in subscription services revenues from the Company's Internet service, Global Network Navigator ("GNN"), which was discontinued in fiscal 1997. The increase in AOL subscription services revenues was primarily attributable to a 39% increase in the average number of AOL North American subscribers for fiscal 1998, compared to fiscal 1997, as well as a 2.7% increase in the average monthly subscription services revenue per AOL North American subscriber. The average monthly subscription services revenue per AOL North American subscriber increased from $17.48 in fiscal 1997 to $17.95 in fiscal 1998. This increase was principally attributable to a reduction in the amount of refunds/credits issued to subscribers in fiscal 1998.

Advertising, Commerce and Other Revenues

An important component of the Company's business strategy in its Interactive Online Services business is an increasing reliance on advertising, commerce and other revenues. These revenues include advertising and electronic commerce fees, the sale of merchandise, as well as other revenues, which consist primarily of royalty fees and development revenues, as well as data network service revenues generated by ANS Communications, Inc. ("ANS") (through its sale in January 1998). The growth of advertising, commerce and other revenues is important to the Company's business objectives, as these revenues provide an important contribution to the Company's operating results. Advertising revenues are expected to grow in importance as the Company continues to leverage its large, active and growing user base. This user base not only includes the paying subscribers of the AOL and CompuServe services, it also includes users of the Company's other branded portals and services such as AOL MovieFone, Netcenter (with more than 17 million registered users), AOL.COM, ICQ (with almost 15 million active registered users) and Digital City. Affecting the growth in advertising, commerce and other revenues is the backlog balance as of June 30, 1999, 1998 and 1997 of $1,519 million, $511 million and $180 million, respectively. During fiscal 2000, approximately $680 million of revenues will be generated from the June 30, 1999 backlog.

The following table summarizes the material components of advertising, commerce and other revenues for the years ended June 30, 1999, 1998 and 1997.

	Year ended June 30					
	1999		1998		1997	
	(Dollars in millions)					
Advertising and electronic commerce fees	$ 765	76.5%	$ 358	65.9%	$ 147	47.7%
Merchandise	134	13.4	103	19.0	109	35.4
Other	101	10.1	82	15.1	52	16.9
Total advertising, commerce and other revenues	$1,000	100.0%	$ 543	100.0%	$ 308	100.0%

Advertising, commerce and other revenues increased by 84%, from $543 million in fiscal 1998 to $1,000 million in fiscal 1999. More advertising on the Company's AOL service and Netcenter portal, as well as an increase in electronic commerce fees drove the increase. Advertising and electronic commerce fees increased by 114%, from $358 million in fiscal 1998 to $765 million in fiscal 1999.

Advertising, commerce and other revenues increased by 76%, from $308 million in fiscal 1997 to $543 million in fiscal 1998. More advertising on the Company's AOL service and Netcenter portal, as well as an increase in electronic commerce fees primarily drove the increase. Advertising and electronic commerce fees increased by 144%, from $147 million in fiscal 1997 to $358 million in fiscal 1998.

Enterprise Solutions Revenues

The Netscape Enterprise Solutions business generates revenues that consist principally of product licensing fees and fees from technical support, consulting and training services. The Netscape Enterprise Group focuses on providing businesses a range of software products, technical support, consulting and training services. These products and services enable businesses and users to share information, manage networks and facilitate electronic commerce on the Internet. In November 1998, the Company entered into a strategic alliance with Sun Microsystems, Inc. ("Sun"), a leader in network computing products and services, to accelerate the growth of electronic commerce. The strategic alliance provides that, over a three year period, the Company will develop and market, together with Sun, client software and network application and server software for electronic commerce, extended communities and connectivity, including software based in part on the Netscape code base, on Sun code and technology and on certain America Online services features, to business enterprises.

Enterprise solutions revenues increased by 25%, from $365 million in fiscal 1998 to $456 million in fiscal 1999. The increase was due to an increase in product sales related to server applications and consulting services coupled with the decline in revenues in fiscal 1998 due to offering the Netscape Communicator client software, including the Netscape Navigator browser for free starting in January 1998.

Enterprise solutions revenues decreased by 11%, from $411 million in fiscal 1997 to $365 million in fiscal 1998. The decrease was due to offering the Netscape Communicator client software, including the Netscape Navigator browser for free starting in January 1998, offset by an 18% increase in product sales related to server applications and consulting services.

Costs and Expenses

The following table and discussion highlights the costs and expenses of the Company for the years ended June 30, 1999, 1998 and 1997.

	Year ended June 30,					
	1999		1998		1997	
	Dollars in millions					
Total revenues	$4,777	100.0%	$3,091	100.0%	$2,197	100.0%
Costs and expenses:						
Cost of revenues	$2,657	55.6%	$1,811	58.6%	[illegible]	[illegible]
Sales and marketing						
Sales and marketing	808	16.9	623	20.2	[illegible]	[illegible]
Write-off of deferred subscriber acquisition costs	-	-	-	-	385	[illegible]
Product development	286	6.0	239	7.7	[illegible]	[illegible]
General and administrative	408	8.5	[illegible]	[illegible]	[illegible]	[illegible]
Amortization of goodwill and other intangible assets	65	1.4	24	0.8	[illegible]	[illegible]
Acquired in-process research and development	-	-	94	3.0	[illegible]	[illegible]
Merger, restructuring and contract termination charges	95	2.0	75	2.4	[illegible]	[illegible]
Settlement charges	-	-	17	0.5	24	[illegible]
Total costs and expenses	$4,319	90.4%	$3,211	103.9%	[illegible]	[illegible]

Cost of Revenues

Cost of revenues includes network-related costs, consisting primarily of data network costs, personnel and related costs associated with operating the data centers, data network and providing customer support, consulting, technical support/training and billing, host computer and network equipment costs, the costs of merchandise sold, royalties paid to information and service providers and royalties paid for licensed technologies.

Since the introduction of the Flat-Rate Plan for the AOL service in December 1996, the Company has experienced a significant increase in both: 1) subscriber usage, which is mainly due to the growth of the subscriber base, and 2) the average monthly usage per subscriber as subscribers spend more and more time online. These increases have the potential to increase network cost on both an absolute dollar basis, as well as a percentage of revenue basis. While the growth in subscriber usage and the related costs generally are consistent with the increases in subscription service revenues, the increase in usage and related costs per subscriber could impact operating margins. Average monthly subscriber usage in the first quarter of fiscal 1997, the last quarter before the introduction of flat-rate pricing, was approximately 7 hours. In fiscal 1998, average monthly subscriber usage ranged between 20 and 23 hours, and was approximately 22 hours in the fourth quarter of fiscal 1998. In fiscal 1999, average monthly subscriber usage ranged between 24 and 27 hours and was approximately 27 hours in the fourth quarter of fiscal 1999. The Company has, and plans to continue to minimize the impact of the aforementioned increases by increasing advertising, commerce and other revenues and by reducing network costs, on a relative basis (either on a per-hour basis or as a percentage of total revenues). An important factor in reducing network costs is the reduction of the costs of operating the Company's data network, on a per-hour basis, through volume discounts and more efficient utilization of AOLnet, the Company's TCP/IP network. The Company expects that the growth in advertising, commerce and other revenues, assuming such growth continues, will provide the Company with the opportunity and flexibility to fund the costs associated with the increased usage resulting from flat-rate pricing, as well as programs designed to grow the subscriber base and meet other business objectives.

For fiscal 1999, cost of revenues increased from $1,811 million to $2,657 million, or 47%, over fiscal 1998, and decreased as a percentage of total revenues from 58.6% to 55.6%. The increase in cost of revenues in fiscal 1999 was primarily attributable to increases in data network costs, host computer and network equipment costs and personnel and related costs associated with operating the data centers, data network, providing customer support, consulting, technical support/training and billing. Data network costs increased primarily as a result of the larger member base and more usage per member. Host computer and network equipment costs, consisting of lease, depreciation and maintenance expenses, increased as a result of additional host computer and network equipment, necessitated by the larger member base and more usage by members. Personnel and related costs associated with operating the data centers, data network, providing customer support and billing increased primarily as a result of the requirements of supporting a larger data network, a larger member base and increased subscription services revenues. Personnel and related costs associated with consulting and technical support/training increased due to providing additional customer support and professional services. The decrease in cost of revenues as a percentage of total revenues was primarily attributable to growth of the higher margin advertising, commerce and other revenues, as well as a decrease in network-related costs as a percentage of subscription services revenue.

For fiscal 1998, cost of revenues increased from $1,162 million to $1,811 million, or 56%, over fiscal 1997, and increased as a percentage of total revenues from 52.9% to 58.6%. The increase in cost of revenues in fiscal 1998 was primarily attributable to increases in data network costs, host computer and network equipment costs and personnel and related costs associated with operating the data centers, data network, providing customer support, consulting, technical support/training and billing. Data network costs increased primarily as a result of the larger member base and more usage per member. Host computer and network equipment costs, consisting of lease, depreciation and maintenance expenses, increased as a result of additional host computer and network equipment, necessitated by the larger member base and more usage by members. Personnel and related costs associated with operating the data centers, data network, providing customer support and billing increased primarily as a result of the requirements of supporting a larger data network, a larger member base and increased subscription services revenues. Personnel and related costs associated with consulting and technical support/training increased due to providing additional customer support and professional services. The increase in cost of revenues, as a percentage of total revenues, in fiscal 1998 was primarily attributable to an increase, as a percentage of total revenues, in host computer and network equipment costs coupled with the decrease in revenues related to the high margin Netscape Communicator client software (including the Netscape Navigator browser) partially offset by a decrease, as a percentage of total revenues, in royalties paid to information and service providers.

Sales and Marketing

Sales and marketing expenses include the costs to acquire and retain subscribers, the operating expenses associated with the sales and marketing organizations and other general marketing costs.

Marketing expenses have declined as a percentage of revenues primarily as a result of the improved value proposition offered by flat-rate pricing, which has resulted in improved subscriber acquisition and retention rates, as compared to rates achieved prior to flat-rate pricing. The Company's marketing strategy is expected to continue to emphasize brand advertising across multiple brands as well as cost-effective bundling agreements, where the Company's products are widely distributed with new personal computers, the Windows operating system and other peripheral computer equipment and software. Additionally, the Company will continue to market its products via direct mail programs.

For fiscal 1999, sales and marketing expenses increased from $623 million to $808 million, or 30%, over fiscal 1998, and decreased as a percentage of total revenues from 20.2% to 16.9%. The increase in sales and marketing expenses for fiscal 1999 was mainly attributable to an increase in direct subscriber acquisition costs, brand advertising across multiple brands and personnel costs associated with expanding the Netscape Enterprise business. The decrease as a percentage of total revenues was primarily a result of the substantial growth in revenues.

For fiscal 1998, sales and marketing expenses increased from $608 million to $623 million, or 2%, over fiscal 1997, and decreased as a percentage of total revenues from 27.7% to 20.2%. The increase in sales and marketing expenses for fiscal 1998 was mainly attributable to an increase in Netcenter staffing and related sales commissions, partially offset by a decrease in subscriber acquisition costs. The decrease as a percentage of total revenues was mainly due to the decrease in subscriber acquisition costs.

The Company made a change in the first quarter of fiscal 1997 which resulted in subscriber acquisition costs being expensed for periods subsequent to the first quarter of fiscal 1997, versus being capitalized and amortized over twenty-four months in the first quarter of fiscal 1997 and prior. As a result of the aforementioned change in accounting estimate, the balance of deferred subscriber acquisition costs as of September 30, 1996, totaling $385 million, was written off. For additional information regarding this change, refer to Note 3 of the Notes to Consolidated Financial Statements.

For fiscal 1998, sales and marketing expenses, before capitalization and amortization, decreased from $679 million to $623 million, or 8.2%, over fiscal 1997, and decreased as a percentage of total revenues from 30.9% to 20.2%. The decrease in sales and marketing expenses for fiscal 1998, before capitalization and amortization, was primarily attributable to a decrease in subscriber acquisition costs. The Company was able to decrease its subscriber acquisition costs primarily as a result of the improved value proposition offered by flat-rate pricing, which has resulted in improved acquisition and retention rates, as compared to rates achieved prior to flat-rate pricing.

Product Development

Product development costs consist of personnel and related costs for research and development efforts and other product development costs either prior to the development effort reaching technological feasibility or once the product has reached the maintenance phase of its life cycle.

For fiscal 1999, product development costs increased from $239 million to $286 million, or 20%, over fiscal 1998, and decreased as a percentage of total revenues from 7.7% to 6.0%. The increase in product development costs was primarily due to an increase in the number of technical employees to support additional products across multiple brands. The decrease in product development costs as a percentage of total revenues was primarily a result of the substantial growth in revenues.

For fiscal 1998, product development costs increased from $195 million to $239 million, or 23%, over fiscal 1997, and decreased as a percentage of total revenues from 8.9% to 7.7%. The increase in product development costs was primarily due to an increase in personnel costs resulting from the Company's acquisitions of Actra Business Systems LLC ("Actra"), KIVA Software Corporation ("KIVA") and the online service of CompuServe (see Note 8 of the Notes to Consolidated Financial Statements). The decrease in product development costs as a percentage of total revenues was primarily a result of the substantial growth in revenues.

General and Administrative

For fiscal 1999, general and administrative expenses increased from $328 million to $408 million, or 24%, over fiscal 1998, and decreased as a percentage of total revenues from 10.6% to 8.5%. The increase in general and administrative costs for fiscal 1999, was primarily attributable to higher personnel costs, including payroll taxes associated with employee stock option exercises. The decrease in general and administrative costs as a percentage of total revenues was primarily attributable to the substantial growth in revenues.

For fiscal 1998, general and administrative expenses increased from $220 million to $328 million, or 49%, over fiscal 1997, and increased slightly as a percentage of total revenues from 10.0% to 10.6%. The increase in general and administrative costs for fiscal 1998, and such costs as a percentage of total revenues, was primarily attributable to higher personnel and related costs, which included compensatory stock options and other charges primarily related to the sale of ANS, as well as increases in professional fees, principally related to legal matters.

Amortization of Goodwill and Other Intangible Assets

Amortization of goodwill and other intangible assets increased to $65 million in fiscal 1999 from $24 million in fiscal 1998 and $6 million in fiscal 1997. The increase in amortization expense over the three years is primarily attributable to goodwill associated with the acquisitions of Mirabilis, Ltd. ("Mirabilis") in June 1998, CompuServe in January 1998, DigitalStyle Corporation ("DigitalStyle") and Portola Communications, Inc. ("Portola") in June 1997, and Actra in December 1997, as well as purchases of various companies made by the Company in late fiscal 1997 and early fiscal 1998. The increase is partially offset by a decrease in goodwill amortization resulting from the disposition of ANS in January 1998 and the shutdown of GNN in the Company's fiscal 1997 restructuring.

Acquired In-Process Research and Development

The Company incurred a total of $94 million in acquired in-process research and development charges in fiscal 1998 related to the acquisitions of Mirabilis, Actra, Personal Library Software, Inc. ("PLS") and NetChannel, Inc. ("NetChannel").

In June 1998, the Company acquired the assets, including the developmental ICQ instant communications and chat technology, and assumed certain liabilities of Mirabilis. The ICQ technology is an enabling technology for online communication. At the date of acquisition, Mirabilis reported 12 million registered trial users of which approximately half were active. The Company paid $287 million in cash and may pay up to $120 million in additional contingent purchase payments based on future performance levels. The Company's Consolidated Statements of Operations reflect a one-time write-off of the amount of purchase price allocated to in-process research and development of approximately $60 million.

The Company allocated the excess purchase price over the fair value of net tangible assets acquired to identified intangible assets. In performing this allocation, the Company considered, among other factors, the attrition rate of the active users of the technology at the date of acquisition (estimated to be similar to the rate experienced by the AOL service) and the research and development projects in-process at the date of acquisition. With regard to the in-process research and development projects, the Company considered, among other factors, the stage of development of each project at the time of acquisition, the importance of each project to the overall development plan, and the projected incremental cash flows from the projects when completed and any associated risks. Associated risks include the inherent difficulties and uncertainties in completing each project and thereby achieving technological feasibility and risks related to the impact of potential changes in future target markets.

During fiscal 1999, the Company incurred approximately $5 million, related primarily to salaries, to develop the in-process technology into commercially viable products and the Company intends to incur approximately $9 million more over the next year. Remaining development efforts are focused on addressing security issues, architecture stability and electronic commerce capabilities, and completion of these projects will be necessary before revenues are produced. The Company expects to begin to benefit from the purchased in-process research and development by its fiscal year 2000. If these projects are not successfully developed, the Company may not realize the value assigned to the in-process research and development projects. In addition, the value of the other acquired intangible assets may also become impaired.

The Company acquired Actra, a developer of commerce applications for conducting business-to-business and business-to-consumer commerce on the Internet in December 1997, PLS, a developer of information indexing and search technologies in January 1998 and NetChannel, a Web-enhanced television company, in June 1998. These transactions were accounted for under the purchase method of accounting. In connection with the purchase of Actra, the Company recorded a charge for acquired in-process research and development of $14 million. In connection with the purchases of PLS and NetChannel, the Company recorded charges for acquired in-process research and development in fiscal 1998 of $10 million related to each acquisition.

The Company incurred a total of $9 million ($5 million and $4 million, respectively) in acquired in-process research and development charges in fiscal 1997 related to the acquisitions of Portola and DigitalStyle in June 1997.

The technology, market and development risk factors discussed above for the Mirabilis acquisition are also relevant and should be considered with regard to the acquisitions of Actra, PLS, NetChannel, Portola and DigitalStyle.

Merger, Restructuring and Contract Termination Charges

In fiscal 1999, the Company recognized charges that totaled $95 million related to restructurings and mergers.

- In connection with the mergers of MovieFone, Inc., Spinner Networks Incorporated, NullSoft, Inc. and AtWeb, Inc. the Company recorded direct merger-related costs of $17 million.
- In connection with plans announced and implemented in March 1999, the Company recorded a charge of $78 million for direct costs related to the merger with Netscape and the Company's reorganization plans to integrate Netscape's operations and build on the strengths of the Netscape brand and capabilities as well as the merger with When, Inc.

In fiscal 1998, the Company recognized net charges of $75 million related to restructurings and mergers.

- In connection with a restructuring plan adopted in the third quarter of fiscal 1998, the Company recorded a $35 million restructuring charge associated with the restructuring of its AOL Studios brand group. The restructuring included the exiting of certain business activities, the termination of approximately 160 employees and the shutdown of certain subsidiaries and facilities.
- At the end of the second and beginning of the third quarters of fiscal 1998, the Company recorded a $35 million restructuring charge related to the implementation of certain restructuring actions mainly related to the Enterprise Solution business. These actions were aimed at reducing its cost structure, improving its competitiveness and restoring sustainable profitability. The restructuring plan resulted from decreased demand for certain Enterprise products and the adoption of a new strategic direction. The restructuring included a reduction in the workforce (approximately 400 employees), the closure of certain facilities, the write-off of non-performing operating assets and third-party royalty payment obligations relating to canceled contracts.
- In the fiscal year ended 1998, the Company recognized merger costs of $6 million related to the acquisition of Kiva Software Corporation, consisting mainly of investment banking, legal and accounting services.
- In connection with a restructuring plan adopted in the second quarter of fiscal 1997, the Company recorded a $49 million restructuring charge associated with the Company's change in business model, the reorganization of the Company into three operating units, the termination of approximately 300 employees and the shutdown of certain operating divisions and subsidiaries. As of the first quarter of fiscal 1998, substantially all of the restructuring activities had been completed and the Company reversed $1 million of the original restructuring accrual in the first quarter of fiscal 1998.

In fiscal 1997, the Company recognized net charges of $73 million related to restructurings and contract terminations.

- In connection with a restructuring plan adopted in the second quarter of fiscal 1997, the Company recorded a $49 million restructuring charge associated with the Company's change in business model, the reorganization of the Company into three operating units, the termination of approximately 300 employees and the shutdown of certain operating divisions and subsidiaries.

- In the fourth quarter of fiscal 1997, the Company recorded a contract termination charge of $24 million, which consists of unconditional payments associated with terminating certain information provider contracts, which became uneconomic as a result of the Company's introduction of flat-rate pricing in December 1996.

Refer to Notes 4 and 5 of the Notes to Consolidated Financial Statements for further information related to the restructurings, contract terminations and merger costs.

Settlement Charges

In fiscal 1998, the Company recorded a net settlement charge of $18 million in connection with the settlement of the Orman v. America Online, Inc. class action lawsuit filed in U.S. District Court for the Eastern District of Virginia alleging violations of federal securities laws between August 1995 and October 1996. Included in the net settlement charge is an estimate of $17 million in insurance receipts.

In fiscal 1997, the Company recorded a settlement charge of $24 million in connection with a legal settlement reached with various State Attorneys General and a preliminary legal settlement reached with various class action plaintiffs, to resolve potential claims arising out of the Company's introduction of flat-rate pricing and its representation that it would provide unlimited access to subscribers. Pursuant to these settlements, the Company agreed to make payments to subscribers, according to their usage of the AOL service, who may have been injured by their reliance on the Company's claim of unlimited access. These payments do not represent refunds of online service revenues, but are rather the compromise and settlement of allegations that the Company's advertising of unlimited access under its flat-rate pricing plan violated consumer protection laws. In the second quarter of fiscal 1998, the Company revised its estimate of the total liability associated with these matters, and reversed $1 million of the original settlement accrual.

Other Income, Net

Other income, net consists primarily of investment income and non-operating gains net of interest expense and non-operating charges. The Company had other income of $638 million and $30 million in fiscal 1999 and fiscal 1998, respectively. The increase in other income in fiscal 1999 was primarily attributable to a net gain of approximately $567 million on the sale of Excite, Inc. investments. The additional increase is mainly due to an increase in net interest income and a reduction of non-operating losses related to various investments. The Company had other income of $30 million and $10 million in fiscal 1998 and fiscal 1997, respectively. The increase in other income in fiscal 1998 was primarily attributable to gains on the sale of certain available-for-sale securities and increases in net interest income partially offset by decreases in the allocation of losses to minority stockholders and increases in non-operating losses related to various investments.

(Provision) Benefit for Income Taxes

The (provision) benefit for income taxes was $(334), $16 and $(10) million in fiscal 1999, fiscal 1998 and fiscal 1997, respectively. The substantial increase in the provision for income taxes in fiscal 1999 is a direct result of the Company's increase in pre-tax income. For additional information regarding income taxes, refer to Note 14 of the Notes to Consolidated Financial Statements.

Segment Results of Operations

The Company operates its two major lines of businesses as Interactive Online Services and Enterprise Solutions. For further information regarding segments, refer to Note 9 of the Notes to Consolidated Financial Statements.

A summary of the segment financial information is as follows:

	Years ended June 30, 1999	1998	1997
	(Amounts in millions)		
Revenues:			
Interactive Online Services	$4,321	$2,726	$1,786
Enterprise Solutions	456	365	411
Total revenues	$4,777	$3,091	$2,197
Income (loss) from operations:			
Interactive Online Services (1),(2)	$ 955	$ 412	$ (257)
Enterprise Solutions (2)	6	(18)	98
General & Administrative	(408)	(328)	(220)
Other (3)	(95)	(186)	(106)
Total income (loss) from operations	$ 458	$ (120)	$ (485)

(1) Loss from operations for the year ended June 1997 includes $385 million write-off of deferred subscriber acquisition costs.
(2) In fiscal 1999, Enterprise Solutions and Interactive Online Services include $5 million and $60 million respectively of goodwill and other intangible assets amortization.
(3) Other consists of all special items; merger, restructuring, contract termination, acquired in-process research and development and settlement charges.

For an overview of the segment revenues, refer to the consolidated results of operations discussion earlier in this section.

Interactive Online Services income from operations increased from $128 million (excluding $385 million write-off of deferred subscriber acquisitions costs) in fiscal 1997 to $412 million in fiscal 1998 and $955 million in fiscal 1999. These increases are mainly the result of increases in subscription services and advertising, commerce and other revenues coupled with improved margins and a decrease in marketing expenses (as a percentage of revenues) resulting from the improved value proposition offered by flat-rate pricing.

Enterprise Solutions income (loss) from operations decreased from $98 million in fiscal 1997 to a loss of $(18) million in fiscal 1998 and increased to income of $6 million in fiscal 1999. The decrease from fiscal 1997 to 1998 was mainly a result of offering the Netscape Communicator client software (including the Netscape Navigator browser) for free starting in January 1998. The increase from fiscal 1998 to 1999 was mainly attributable to the increase in revenues.

Liquidity and Capital Resources

The Company is currently financing its operations primarily through cash generated from operations. During fiscal 1999, the Company generated more than $1 billion in cash from operations. In addition, the Company has generated cash from the sale of its capital stock, the sale of its convertible notes as well as the sale of marketable securities it held. The Company has financed its investments in telecommunications equipment principally through leasing. Net cash provided by operating activities was $1,099 million, $437 million and $131 million in fiscal 1999, 1998 and 1997, respectively, and increased primarily due to the Company's increase in net income. Net cash used in investing activities was $1,776 million, $531 million and $367 million in fiscal 1999, fiscal 1998 and fiscal 1997, respectively. The increase in cash used in investing activities is mainly due to the Company's $1.5 billion investment in a General Motors equity security related to the strategic alliance the Company entered with Hughes Electronics Corporation ("Hughes"). For additional information regarding this investment, refer to Note 8 of the Notes to the Consolidated Financial Statements. The increase in cash used in investing activities was offset by net proceeds of approximately $600 million related to the sale of Excite, Inc. investments during fiscal 1999. Net cash provided by financing activities was $887 million, $580 million and $250 million in fiscal 1999, fiscal 1998 and fiscal 1997, respectively. Included in financing activities for fiscal 1999, were $550 million in aggregate net proceeds from a public stock offering of its common stock.

The Company uses its working capital to finance ongoing operations and to fund marketing and the development of its products and services. The Company plans to continue to invest in subscriber acquisition, retention and brand marketing to expand its subscriber base, as well as in network, computing and support infrastructure. Additionally, the Company expects to use a portion of its cash for the acquisition and subsequent funding of technologies, content, products or businesses complementary to the Company's current business. The Company anticipates that cash on hand and cash provided by operating activities will be sufficient to fund its operations for the next twelve months. The Company currently has approximately $450 million available under a shelf registration filed in June 1998. In May 1999, the Company filed a registration statement to raise an additional $4.5 billion by sale of the Company's debt securities, common stock, preferred stock depositary shares, warrants or stock purchase contracts to purchase common stock or preferred stock. The total offering price of these securities, in the aggregate, will not exceed $5 billion.

At June 30, 1999, the Company had working capital of $254 million, compared to working capital of $108 million at June 30, 1998. In addition, the Company had investments including available-for-sale securities of $2,151 million and $531 million at June 30, 1999 and 1998, respectively. Current assets increased by $716 million, from $1,263 million at June 30, 1998 to $1,979 million at June 30, 1999, while current liabilities increased by $570 million, from $1,155 million to $1,725 million, over this same period. The increase in current assets was primarily attributable to an increase in cash and short-term investments resulting from cash generated by operations. The change in current liabilities was due to increases in other accrued expenses and liabilities, primarily related to an increase in accrued telecommunications costs, as well as an increase in deferred revenues.

During July 1998, the Company improved its cash and working capital balances as a result of a public offering of common stock. The Company sold 21,560,000 shares of common stock and raised a total of $550 million in new equity which was used to fund general corporate purposes. In November 1997, the Company sold $350 million of 4% Convertible Subordinated Notes due November 15, 2002 (the "Notes"). The Notes are convertible into the Company's common stock at a conversion rate of 76.63752 shares of common stock for each $1,000 principal amount of the Notes (equivalent to a conversion price of $13.04844 per share), subject to adjustment in certain events. Interest on the Notes is payable semiannually on May 15 and November 15 of each year, commencing on May 15, 1998. The Notes may be redeemed at the option of the Company on or after November 14, 2000, in whole or in part, at the redemption prices set forth in the Notes.

In June 1998, the Company purchased Mirabilis for $287 million in cash (and contingent purchase price payments of up to $120 million) and NetChannel for $16 million in cash. For additional information regarding these acquisitions, see Note 8 of the Notes to Consolidated Financial Statements.

In January 1998, the Company consummated a Purchase and Sale Agreement (the "Purchase and Sale") by and among the Company, ANS Communications, Inc. ("ANS"), a then wholly-owned subsidiary of the Company, and MCI WorldCom, Inc. ("WorldCom") pursuant to which the Company transferred to WorldCom all of the issued and outstanding capital stock of ANS in exchange for the online services business of CompuServe Corporation ("CompuServe"), which was acquired by MCI WorldCom shortly before the consummation of the Purchase and Sale, and $147 million in cash (excluding $15 million in cash received as part of the CompuServe online services business and after purchase price adjustments made at closing). Immediately after the consummation of the Purchase and Sale, the Company's European partner, Bertelsmann AG, paid $75 million to the Company for a 50% interest in a newly created joint venture to operate the CompuServe European online service. Each company invested an additional $25 million in cash in this joint venture. The Company generated $207 million in net cash as a result of the aforementioned transactions.

The Company enters into multiple-year data communications agreements in order to support AOLnet. In connection with those agreements, the Company may commit to purchase certain minimum data communications services. Should the Company not require the delivery of such minimums, the Company's per hour data communications costs may increase. For additional information regarding the Company's commitments, see Note 11 of the Notes to Consolidated Financial Statements.

In May 1996, the Company entered into a joint venture with Mitsui & Co., ("Mitsui") and Nihon Keizai Shimbun, Inc. ("Nikkei") to offer interactive online services in Japan. In connection with the agreement, the Company received approximately $28 million through the sale of convertible preferred stock to Mitsui. The preferred stock had an aggregate liquidation preference of approximately $28 million and accrued dividends at a rate of 4% per annum. Accrued dividends could be paid in the form of additional shares of preferred stock. During May 1998, the preferred stock, together with accrued but unpaid dividends, was converted into 1,568,000 shares of common stock based on the fair market value of common stock at the time of conversion.

The Company leases the majority of its equipment under non-cancelable operating leases. It is building AOLnet, its data communications network, as well as expanding its data center capacity. The buildout of AOLnet and the expansion of data center capacity requires a substantial investment in telecommunications and server equipment. The Company plans to continue making significant investments in these areas. The Company is funding these investments, which are anticipated to total approximately $1 billion in fiscal 2000, through a combination of leases, debt financing and cash purchases.

Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA")

The following table and discussion summarizes EBITDA for the years ended June 30, 1999, 1998 and 1997:

	Years ended June 30,		
	1999	1998	1997
	(Amounts in millions)		
EBITDA	$968	$302	$111

The Company defines EBITDA as net income plus: (1) provision/(benefit) for income taxes, (2) interest expense, (3) depreciation and amortization and (4) special charges. For the fiscal year ended June 30, 1997, EBITDA does not add back the amortization of subscriber acquisition costs. EBITDA is presented and discussed because the Company considers EBITDA an important indicator of the operational strength and performance of its business including the ability to provide cash flows to service debt and fund capital expenditures. EBITDA, however, should not be considered an alternative to operating or net income as an indicator of the performance of the Company, or as an alternative to cash flows from operating activities as a measure of liquidity, in each case determined in accordance with generally accepted accounting principles ("GAAP").

For fiscal 1999, EBITDA increased from $302 million to $968 million or 221% over fiscal 1998. For fiscal 1998, EBITDA increased from $111 million to $302 million or 172%. The increase from fiscal 1998 to 1999 is mainly due to the significant increase in income before taxes (excluding special charges) from $96 million in fiscal 1998 to $649 million in fiscal 1999 as well as an increase of approximately $100 million in depreciation and amortization. The increase from fiscal 1997 to 1998 is due to the increase in income before taxes (excluding special charges) from $16 million in fiscal 1997 to $96 million in fiscal 1998 as well as an increase of approximately $100 million in depreciation and amortization.

Seasonality

The growth in subscriber acquisitions and usage in the Company's online services appears to be highest in the second and third fiscal quarters, when sales of new computers and computer software are highest due to the holiday season and following the holiday season, when new computer and software owners are discovering Internet online services while spending more time indoors due to winter weather. However, the Company does not definitively know whether such increases in subscriber acquisitions and usage are primarily attributable to seasonal factors or to increased demand for Internet online services as a result of the growing market demand and utility for such services.

Since making advertising revenue a key component of the Company's strategy in its Interactive Online Services business, the Company has experienced difficulty in distinguishing seasonality in advertising sales from the overall market growth. Seasonal factors seem to be mitigated by advertisers' growing interest in the overall online medium as well as gaining access to the Company's large and growing subscriber/user base across multiple branded distribution channels. When the online advertising industry matures and online advertising budgets experience normal growth, the Company expects to experience the effects of seasonality in securing advertising commitments.

Year 2000 Compliance

The Company utilizes a significant number of computer software programs and operating systems across its entire organization, including applications used in operating its online services and Web sites, the proprietary software of the AOL and CompuServe services, Netscape software products, member and customer services, network access, content providers, joint ventures and various administrative and billing functions. To the extent that these applications contain source codes that are unable to appropriately interpret the upcoming calendar year 2000, some level of modification, or even possibly replacement may be necessary.

In 1997, the Company appointed a Year 2000 Task Force to perform an audit to assess the scope of the Company's risks and bring its applications into compliance. This Task Force oversees testing and is continuing its assessment of the Company's company-wide compliance. The Company's system hardware components, client and host software, current versions of Netscape software products and corporate business and information systems are currently undergoing review and testing. To date, the Company has experienced few problems related to Year 2000 testing, and the problems that have been identified are in the process of being addressed.

The Company intends to make Year 2000 compliant certain versions of the client software for the AOL service and the CompuServe service that are available on the Windows and Macintosh operating systems, as well as versions of Netscape software products that are currently shipped. While the majority of AOL and CompuServe members use proprietary client software that will be compliant, a third-party internet browser utilized in most versions of the client software may not be Year 2000 compliant. A free patch or upgrade will be required for members using some versions of the client software or browser to achieve Year 2000 compliance. In the coming months, the Company will encourage members of its online services to upgrade their browser and/or their software to versions that are expected to be Year 2000 compliant, if they have not already done so. The Company will make available to members, and communicate that availability, free patches or upgrades that can be downloaded from the online services. The Company has not tested, and does not expect to certify as Year 2000 compliant, certain older versions of the AOL and CompuServe software. The Company has developed, and will be implementing over the remainder of the year, a communication program that informs members how to obtain the free patch or upgrade to a Year 2000 compliant version of the client software or browser. With respect to the Company's Netscape software business, testing continues on currently shipped products. The Company also will make available, at no additional cost to customers, any required patch to the versions of Netscape software products currently being shipped to customers and communicate their availability. In addition, the Company will be encouraging customers to upgrade to versions of the software that are expected to be Year 2000 compliant, if they have not already done so.

In addition, the Company is continuing to gather information from its vendors, joint venture partners and content partners about their progress in identifying and addressing problems that their computer systems may face in correctly processing date information related to the Year 2000. The Company intends to continue its efforts to seek reassurances regarding the Year 2000 compliance of vendors, joint venture partners and content partners. In the event any third parties cannot timely provide the Company with content, products, services or systems that meet the Year 2000 requirements, the content on the Company's services, access to the Company's services, the ability to offer products and services and the ability to process sales could be materially adversely affected.

The costs incurred through June 30, 1999 to address Year 2000 compliance were approximately $11 million. The Company currently estimates it will incur a total of approximately $20 million in costs to support its compliance initiatives. The Company cannot predict the outcome of its Year 2000 program, whether third party systems and component software are, or will be Year 2000 compliant, the costs required to address the Year 2000 issue, or whether a failure to achieve substantial Year 2000 compliance will have a material adverse effect on the Company's business, financial condition or results of operations. Failure to achieve Year 2000 compliance could result in some interruptions in the work of some employees, the inability of some members and customers to access the Company's online services and Web sites or errors and defects in the Netscape products. This, in turn, may result in the loss of subscription services revenue, advertising and commerce revenue or enterprise solution revenue, the inability to deliver minimum guaranteed levels of traffic, diversion of development resources, or increased service and warranty costs. Occurrence of any of these may also result in additional remedial costs and damage to reputation.

The Company has developed a contingency plan to address possible Year 2000 risks to its systems. The plan identifies a hierarchy of critical functions, acceptable delay times, recovery strategies to return functions to operational status and defines the core team for managing this recovery process. The Company will continue to modify this plan to address systems of its recent acquisitions.

Inflation

The Company believes that inflation has not had, and will not have in the future, a material effect on its results of operations.

Forward-Looking Statements

This report and other oral and written statements made by the Company to the public contain and incorporate by reference forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements are based on management's current expectations or beliefs and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Such statements address the following subjects: future operating results; subscriber growth and retention; advertising, commerce and other revenues; earnings growth and expectations; development and success of multiple brands; new products and services (such as AOL 5.0, and the "You've Got Pictures," "My Calendar," AOL Search and AOL Plus features); corporate spending; liquidity; network capacity; new access and distribution technologies; regulatory developments, including the Company's ability to shape public policy in, for example, telecommunications, privacy and tax areas.

The following factors, among others, could cause actual results to differ materially from those described in the forward-looking statements:

The risk that the Company and its data communications access providers will be unable to provide adequate server and network capacity. Risks associated with the fixed costs and minimum commitment nature of a substantial majority of the Company's network services, such that a significant decrease in demand for online services would not result in a corresponding decrease in network costs. Risks related to the build-out of AOLnet and the expansion of server and network capacity; the risk that demand will not develop for the capacity created; the risk that supply shortages for hardware and equipment and for local exchange carrier lines from local telephone companies could impede the provision of adequate network and system capacity; and the risk of the failure to obtain the necessary financing.

Any damage or failure to the Company's computer equipment and the information stored in its data centers.

Factors related to increased competition, including: price reductions and increased spending; inability to generate greater revenues and profits from advertising and electronic commerce; limitations on the Company's opportunities to enter into or renew agreements with content providers and distribution partners; limitations on the Company's ability to develop new products and services; limitations on the Company's ability to continue to grow or sustain its subscriber base; loss of the Company's market share in the enterprise software industry; and an adverse impact on gross and operating margins.

The failure to increase revenues at a rate sufficient to offset the increase in data communications and equipment costs resulting from increasing usage.

The risk of loss of services of executive officers and other key employees.

The risk that because of seasonal and other factors, the Company is unable to predict growth in sales, usage, subscriber acquisitions and advertising commitments.

The failure of the Company to establish new relationships with electronic commerce, advertising, marketing, technology and content providers or the loss of a number of relationships with such providers or the risk of significantly increased costs or decreased revenues needed, to maintain, or resulting from the failure to maintain, such relationships, as the case may be.

The risk associated with accepting warrants in lieu of cash in certain electronic commerce agreements, as the value of such warrants is dependent upon the common stock price of the warrant issuer at the time the warrants are earned.

The risks related to the acquisition of businesses, including the failure to successfully integrate and manage acquired technology, operations and personnel, the loss of key employees of the acquired companies and diversion of the Company's management's attention from other ongoing business concerns; and the risk of significant charges for in-process research and development or other matters.

The inability of the Company to introduce new products and services; and its inability to develop, or achieve commercial acceptance for, these new products and services. The failure to resolve issues concerning commercial activities via the Internet, including security, reliability, cost, ease of use and access. The risk of adverse changes in the U.S. regulatory environment surrounding interactive services.

The failure of the Company or its partners to successfully market, sell and deliver its services in international markets, and risks inherent in doing business on an international level, such as laws that differ greatly from those in the United States, unexpected changes in regulatory requirements, political risks, export restrictions and controls, tariffs and other trade barriers and fluctuations in currency exchange rates.

The Company's inability to offer its services through advanced distribution technologies such as cable and broadcast, and the resulting inability to offer advanced services such as voice and full motion video. The Company's inability to develop new technology or modify its existing technology to keep pace with technological advances and the pursuit of these technological advances requiring substantial expenditures.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to immaterial levels of market risks, including changes in foreign currency exchange rates and interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices, such as foreign currency exchange and interest rates. The Company does not enter into derivatives or other financial instruments for trading or speculative purposes. The Company only enters into financial instruments to manage and reduce the impact of changes in foreign currency exchange rates. In June 1998, the Company initiated hedging activities to mitigate the impact on intercompany balances of changes in foreign exchange rates. The Company is using foreign currency forward exchange contracts as a vehicle for hedging these intercompany balances. A foreign currency forward exchange contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates on specified dates and to make or receive an equivalent U.S. dollar payment equal to the value of such exchange. For these contracts that are designated and effective as hedges, realized and unrealized gains and losses resulting from changes in the spot exchange rate (including those from open, matured and terminated contracts) are included in other income and net discounts or premiums (the difference between the spot exchange rate and the forward exchange rate at inception of the contract) are also accreted or amortized to other income, over the life of each contract, using the straight-line method. These gains and losses offset gains and losses on intercompany balances, which are also included in other income. The related amounts due to or from counterparties are included in other assets or other liabilities. In general, these foreign currency forward exchange contracts mature in three months or less. The estimated fair value of the contracts are immaterial due to their short-term nature.

Item 8. Financial Statements and Supplementary Data

Reference is made to the financial statements listed under the heading "(a) (1) Consolidated Financial Statements" of Item 14 hereof, which financial statements are incorporated herein by reference in response to this Item 8.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

The response to this item is incorporated by reference from the Sections titled "Management" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Registrant's Proxy Statement for its 1999 Annual Meeting of Stockholders.

Item 11. Executive Compensation

The response to this item is incorporated by reference from the Section titled "Executive Compensation," but not from the Sections titled "Executive Compensation—Performance Graph" and "Executive Compensation—Report on Executive Compensation by the Compensation and Management Development Committee of the Board of Directors," in the Registrant's Proxy Statement for its 1999 Annual Meeting of Stockholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The response to this item is incorporated by reference from the Section titled "Share Ownership" in the Registrant's Proxy Statement for its 1999 Annual Meeting of Stockholders.